Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States

DICK CORPORATION and GE SUPPLY COMPANY,

Petitioners,

v.

MELLON BANK, N.A.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Can a debtor in a bankruptcy proceeding convey to a secured creditor the right to recover a preference, for the sole benefit of the secured creditor, pursuant to Section 550(a) of the Bankruptcy Code, 11 U.S.C. §101 *et seq.*, which allows a trustee or debtor-in-possession to "recover, for the benefit of the estate" property that was preferentially transferred under Section 547 of the Code?

2. Can the statutory authority that Congress conferred on a trustee, debtor-in-possession, or a representative of the estate appointed under a confirmed plan, also be exercised by a secured creditor, acting in the debtor's stead, for its own benefit?

3. Is it a "recovery, for the benefit of the estate," for a secured creditor to provide financing to a bankruptcy estate for the sole purpose of financing a sale of a going concern where all proceeds of the sale will go to the secured creditor?

PARTIES AND CORPORATE DISCLOSURE STATEMENT

Petitioners (appellees below) are Dick Corporation and GE Supply Company. Dick Corporation is a non-public company that is a wholly owned subsidiary of Dick Enterprises, Inc. No publicly held company owns 10% or more of Dick Enterprises, Inc.'s stock. GE Supply is a division of General Electric Company, which is a New York corporation and publicly traded.

Respondent is Mellon Bank, N.A., as agent for the following prepetition senior lenders of Qualitech Steel Corp:

Bank Austria Creditanstalt
Bank of America
Banque Nationale de Paris (nka BNP Paribas)
Comerica Bank
Harris Trust and Savings Bank
Kreditanstalt für Wiederaufbau
LaSalle Bank, N.A.
Mellon Bank, N.A.
National City Bank, Indiana
The Sanwa Bank, Limited
Westdeutsche Landesbank Girozentrale
Keybank Corporation
Credit Suisse/First Boston
GATX Capital Corp.

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PETITION FOR WRIT OF CERTIORARI

Dick Corporation and GE Supply Company petition for a writ of certiorari to review the judgment and Opinion of the United States Court of Appeals for the Seventh Circuit entered on December 4, 2003 pursuant to Rule 10(c) of the Rules of the Supreme Court of the United States.

CITATIONS OF REPORTS OF OPINIONS ENTERED IN THE CASE

The opinion of the United States Court of Appeals for the Seventh Circuit is reported at *Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003), and appears in the Appendix hereto at App. 1. The opinion of the United States District Court for the Southern District of Indiana is reported at 2003 U.S. Dist. LEXIS 9427 (S.D. Ind. May 9, 2003), and appears in the Appendix hereto at App. 9. The opinion of the United States Bankruptcy Court for the Southern District of Indiana, Indianapolis Division is not reported but appears in the Appendix hereto at App. 57.

BASIS FOR SUPREME COURT JURISDICTION

The Bankruptcy Court had jurisdiction over the adversary proceeding in this bankruptcy case pursuant to 28 U.S.C. §1334(b) and 28 U.S.C. §151. The District Court had jurisdiction over the appeal from the Bankruptcy Court pursuant to 28 U.S.C. §158(a). The Seventh Circuit Court of Appeals had jurisdiction over the appeal from the final order of the District Court pursuant to 28 U.S.C. §158(d). This Court has jurisdiction over this Petition for

Writ of Certiorari pursuant to 28 U.S.C. §1254(1). The present petition is timely filed under 28 U.S.C. §2101(c) and under Rule 13.1 of this Court.

STATUTES INVOLVED

This case involves various sections of the United States Bankruptcy Code, 11 U.S.C. §101 *et seq.* The specific issues raised involve Section 550(a) of the Code, which provides:

> **§550. Liability of transferee of avoided transfer**
>
> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from –
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

Also involved is Section 547(b) of the Code, which provides:

> **§547. Preferences.**
>
> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

STATEMENT OF THE CASE

On or about June 20, 1996, Qualitech Steel Corporation ("Qualitech") entered into a contract with Petitioner Dick Corporation ("Dick Corp.") pursuant to which Dick Corp. became the general contractor for the construction of a state-of-the-art mini steel mill in Pittsboro, Indiana. App. 11. Petitioner GE Supply Company ("GE") sold gas

turbine engines to Qualitech, which were used at Qualitech's mill, as well as service and parts for those engines, between January 26, 1999 and March 10, 1999. *Id.*

On March 22, 1999, Qualitech and its parent company, Qualitech Steel Holding Corp. (collectively "the Debtors"), filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Southern District of Indiana. *Id.* The bankruptcy was not filed for rehabilitative purposes, but rather to facilitate the sale of Qualitech's assets. *Id.* After the filing, Qualitech operated as a debtor-in-possession pursuant to Section 1107 of the Bankruptcy Code. App. 58, ¶1. At the time of the bankruptcy filing, Qualitech owed Dick Corp. in excess of $7 million. It owed GE in excess of $1.5 million. App. 11.

In or about May 1999, the Bankruptcy Court entered an Order approving the Debtors' financing arrangement with their Prepetition Senior Lenders, which included Respondent Mellon Bank, N.A. ("Mellon"), one of the Prepetition Lenders and the group's collateral agent. App. 13. The purpose of the DIP financing was to allow Qualitech to continue operating so that it could be sold as a going concern rather than holding a liquidation sale of its assets, all for the benefit of these secured creditors. App. 52, 59, ¶ 2. Under the arrangement, the Prepetition Lenders were afforded a lien on certain prepetition and postpetition assets of the Debtors. App. 13. Included in the collateral conveyed to the Prepetition Lenders in the financing arrangement were the Debtors' postpetition avoidance actions, including preference recovery actions under Section 547 of the Bankruptcy Code, 11 U.S.C. §547. App. 13-14.

In June 1999, the Debtors conducted an auction, at which Mellon, on behalf of the Prepetition Lenders, credit bid $180,000,000 of its lien and purchased substantially all of the Debtors' assets. App. 15. On August 13, 1999, the Bankruptcy Court entered an Order approving the sale pursuant to Sections 363 and 365 of the Bankruptcy Code. App. 15.

On November 3, 1999, the Official Committee of Unsecured Creditors of Qualitech Steel Corporation ("the Committee") filed a motion seeking leave to bring preference avoidance actions on behalf of the Debtors. App. 16. Mellon opposed the motion, stating that the proceeds of such avoidance actions were assets that belonged to the Prepetition Lenders. App. 17. The bankruptcy court denied the Committee's motion, which was upheld by the Seventh Circuit on appeal. *See In the Matter of Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001). App. 17-18.

Following the Debtors' decision not to pursue any avoidance actions because there would be no benefit to the estate, the Prepetition Secured Lenders and the Debtors entered into a stipulation proposing to assign the Debtors' avoidance actions to the Prepetition Lenders. App. 18-22. The Court approved the stipulation on June 5, 2000. App. 18. Pursuant to this stipulation, the Prepetition Secured Lenders were entitled to the expenses of litigation plus the first $30 million recovered in any avoidance actions. App. 20-21. It is undisputed that $30 million will not be collected in the avoidance actions which Mellon seeks to prosecute. App. 39.

On June 29, 2000, Mellon commenced five preference avoidance actions in the Bankruptcy Court seeking total recoveries of approximately $1.8 million. App. 66, ¶22.

Among the five actions was one against Dick Corp. seeking recovery of alleged preferential transfers of $550,000 and another against GE seeking $344,349.65. *Id.* Once the various preference actions are complete, it is Qualitech's intention to have the bankruptcy case dismissed. App. 36, 39. No plan of reorganization will be filed or confirmed in this case. App. 52.

The parties filed cross-motions for summary judgment. On August 6, 2001, the Bankruptcy Court granted the summary judgment motions of Dick Corp. and GE and denied Mellon's motion. App. 55. In its opinion, the Bankruptcy Court held that it lacked subject matter jurisdiction because the avoidance actions had been transferred out of the estate. The Court alternatively held that because the actions were being brought solely for the benefit of the secured creditors, they were not brought "for the benefit of the estate," as required by Section 550 of the Code.

Mellon appealed to the District Court, which reversed the Bankruptcy Court's conclusion that it lacked subject matter jurisdiction but affirmed the Bankruptcy Court's holding that Mellon lacked standing to bring the avoidance actions.

Mellon appealed the District Court's decision to the Seventh Circuit, which reversed the District Court in an Opinion dated December 4, 2003.

REASONS FOR GRANTING THE WRIT

In a highly publicized opinion, the Court of Appeals for the Seventh Circuit dramatically changed the fundamental economics of the bankruptcy process. In its Opinion of

December 4, 2003, the Seventh Circuit held that a Chapter 11 debtor-in-possession may assign to a *secured creditor* the *debtor's statutory right* to recover a preferential transfer and that the secured creditor may also then recover the transfer *for the exclusive benefit of the secured creditor*.

The Seventh Circuit's holding is in conflict with the plain language of Section 550(a) of the Bankruptcy Code, which states that "*the trustee*" (which includes a Chapter 11 debtor-in-possession) "may *recover, for the benefit of the estate*, the property transferred" under Section 547.

Not surprisingly, in the few weeks since its publication, the Court's opinion has been the subject of numerous bankruptcy articles that elaborate on its impact. *See, e.g.*, Dan Schecter, *Preference Claims Assigned to Lenders Were "For the Benefit of the Estate" Even Though Preference Recoveries Did Not Follow to Estate [Mellon Bank vs. Dick Corp. (7th Cir.)]*, 2003 Comm.Fin. News. 104 (2003) (observing that *Mellon Bank* "sets precedent throughout the federal court system" and stands for the broad proposition that the benefit to the estate can occur at any time); Randall D. Crocker, *On the Edge*, 23-FEB Am. Bankr.Inst. J. 28 (2004) (questioning *Mellon Bank's* reliance on *Hartford Underwriters Inc. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000) – explaining that "the [Supreme] court [in *Hartford Underwriters*] did not endorse the estate's power to assign its statutory claims and noting that, post-*Mellon Bank*, the entire recovery for the benefit of a secured creditor is now acceptable"); David Lander & Thompson Coburn, *A Snapshot of Recent Avoidance Cases*, 2004 No. 2 Norton Bankr.L. Adviser 2 (2004) (discussing *Mellon Bank* and noting that post-*Mellon Bank*, the concept of benefit to the estate is now unbounded).

This Court should grant certiorari to address this important issue of federal bankruptcy law, which has national impact on the rights of creditors.

I. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting A Secured Creditor To Recover A Preferential Transfer For Its Own Benefit Is Contrary To The Plain Language Of Section 550 Of The Bankruptcy Code And Has Widespread National Implications.

When Congress enacted the Bankruptcy Code in 1978, it established a complex statutory scheme designed to protect and balance the interests of debtors and creditors. The avoidance provisions in the Code, which enable a trustee or debtor-in-possession to recover certain transfers "for the benefit of the estate" are an important part of the overall statutory scheme as they provide tools for promoting fairness in the distribution of the debtor's assets.

In the twenty-five years since its enactment, the Bankruptcy Code has been the subject of numerous opinions by this Court. In its opinions, this Court has consistently ruled that the lower courts must enforce the Bankruptcy Code according to its precise terms. *See, e.g., Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000); *Union Bank v. Wolas*, 502 U.S. 151, 158 (1991); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). In this instance, the Seventh Circuit went beyond the plain language of the Bankruptcy Code when it reversed the decisions of the bankruptcy court and the district court and permitted the secured creditor to maintain a cause of action that, if

successful, would result in a recovery for the secured creditor and not the estate.

Section 550 of the Code provides:

> **§550. Liability of transferee of avoided transfer**
>
> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, *the trustee may recover, for the benefit of the estate, the property transferred,* or, if the court so orders, the value of such property, from –
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. §550(a) (emphasis added).

In this case, the Section 547 preference actions commenced by Mellon, a secured creditor, sought to recover $550,000 from Dick Corp. and $344,349.65 from GE, unsecured creditors of Qualitech, and redirect those funds to Mellon, a secured creditor. The funds recovered would therefore not be "*for the benefit of the estate*," as required by Section 550, but would be for the benefit of a *secured creditor* – Mellon. The plain language of the Bankruptcy Code simply does not allow such a result.

As this Court recognized in *Hartford Underwriters*, "Congress says in a statute what it means and means in a statute what it says there." 530 U.S. at 6. Where, as here, "the statute's language is plain, the sole function of the court – at least where the disposition required by the text

is not absurd – is to enforce it according to its terms." *Id.* (quotations omitted). Accordingly, in *Hartford Underwriters*, this Court held that Section 506(c), which confers on "the trustee" the right to surcharge property that secures a claim, permitted recovery by the trustee or debtor-in-possession but not by any other party. *Id.*

Hartford Underwriters acknowledged but specifically declined to address the issue of whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing a recovery under Section 506(c). 530 U.S. at 13 n.5. The related issue here – whether a secured creditor can act in the trustee's stead to pursue a preference recovery under Section 550 – has not been addressed by this Court.

Bankruptcy courts construing Section 550 have held that the statute's use of the phrase "for the benefit of the estate" is not satisfied when the recovery benefits only a secured creditor. *See, e.g., In re Huntsville Small Engines, Inc.*, 228 B.R. 9, 13 (Bankr. N.D. Ala. 1998) ("where recovery will benefit an entity other than the estate, Section 550's requirement that recovery be for the benefit of the estate is not satisfied"); *In re North Atlantic Millwork Corp.*, 155 B.R. 271 (Bankr. D. Mass. 1993) (dismissing preference actions brought by secured creditors where proceeds of recovery would go directly to secured creditors); *Congress Credit Corp. v. AJC Intern.*, 186 B.R. 555 (D.P.R. 1995) (where party asserting avoidance had a lien on proceeds of recovery, there was no benefit to estate and party lacked standing); *accord In re Metal Brokers Int'l, Inc.*, 225 B.R. 920 (Bankr. E.D. Wis. 1998).

Moreover, the pledging of the preference causes of action by Qualitech to Mellon did not constitute a "recover[y], for

the benefit of the estate, [of] the property transferred" by the trustee. The plain reading of this statute contemplates that the actual recovery of the claim will benefit the estate. This recovery of the proceeds of a cause of action cannot occur until the cause of action has been commenced. Thus, the pledge of the proceeds of a yet to be commenced cause of action as part of an agreement regarding adequate protection for post-petition financing cannot constitute a "recover[y], for the benefit of the estate, [of] the property transferred" by the trustee.

This Court should grant the writ to resolve the conflict between the Seventh Circuit and the decisions of bankruptcy courts nationwide.

II. This Court Should Grant The Writ Because The Seventh Circuit's Opinion Permitting Mellon To Pursue A Preference Action Is Either Contrary To This Court's Decision In *Hartford Underwriters* Or Presumes The Answer To The Question Reserved In *Hartford Underwriters*.

In *Hartford Underwriters*, 530 U.S. 1, this Court, applying its rule of plain construction of Federal statutes, held that a creditor insurance company could not utilize Bankruptcy Code Section 506(c) to surcharge the collateral of a secured creditor for a benefit that the insurance company provided to the secured creditor. In so ruling, this Court relied on the plain language of the statute, which provides that "the trustee may recover," to conclude that a third party did not have standing to recover for its own benefit.

In footnote five of *Hartford Underwriters*, the Court specifically stated that it was not deciding whether a

bankruptcy court may permit creditors and creditors' committees to bring derivative actions in the trustee or debtor's stead:

> *We do not address whether a bankruptcy court can allow other interested parties to act in the trustee's stead in pursuing recovery under §506(c). Amici American Insurance Association and National Union Fire Insurance Co. draw our attention to the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions, see 11 U.S.C. §§544, 545, 547(b), 548(a), 549(a), mention only the trustee.* See, *e.g.*, *In re Gibson Group, Inc.*, 66 F.3d 1436, 1438 (C.A.6 1995). Whatever the validity of that practice, it has no analogous application here, since petitioner did not ask the trustee to pursue payment under §506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead. Petitioner asserted an independent right to use §506(c), which is what we reject today. Cf. *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 202-203 (C.A.7 1988) (holding that creditor had no right to bring avoidance action independently, but noting that it might have been able to seek to bring derivative suit).

Hartford Underwriters, 530 U.S. at 13 n.5 (emphasis added).

This Court should consider this case in the context of *Hartford Underwriters*. Like the statute at issue in *Hartford Underwriters*, the preference statute, Section 547 of the Bankruptcy Code provides, that "the trustee may" take the required action. 11 U.S.C. §547(b). If Mellon's assertion of the preference case was for its own benefit, and the

action was therefore in its own right, this Court should accept certiorari, as the Seventh Circuit's holding would conflict with *Hartford Underwriters,* which holds that when a trustee is identified in the statute as the party with standing to bring an action, a third party creditor is not permitted to act.[1] *See also Colonial Sec. Corp. v. Allen*, 1983 Del.Ch. LEXIS 393,*8 (Del.Ch. April 18, 1983) (in a derivative action, the benefit of the recovery runs to the corporation rather than to the plaintiff individually).

Alternatively, to the extent Mellon is seen as acting derivatively, the issue before this Court is precisely the issue that was left unanswered in footnote 5 of *Hartford Underwriters*. It is an issue which continues to work its way to this Court, most recently in connection with the petitions for a writ of certiorari recently filed in the *Cybergenics* cases. [Nos. 03-327 and 03-330]. And as evidenced by the multiple amici briefs filed in the *Cybergenics* cases, the issue is clearly of national importance. The *Cybergenics* cases, like most bankruptcy preference cases, settled before the Court ruled on the petition. *Lincolnshire Management, Inc. v. Official Committee of Unsecured Creditors of Cybergenics Corp.*, 124 S.Ct. 530 (U.S. Nov. 06, 2003) (No. 03-327, R46-002); *Chinery v. Official Committee of*

[1] The Code provides for two other individuals or entities that may bring a preference case. Pursuant to Section 1107 of the Bankruptcy Code, a Chapter 11 debtor in possession (here Qualitech) may perform the function of a trustee. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, n.3 (1983). Alternatively, pursuant to Section 1123(b)(3)(B), a representative of the Chapter 11 estate appointed for the purpose of pursuing claims under a confirmed plan may bring such an action. *In re DeLaurentiis Entertainment Group*, 87 F.3d 1061 (10th Cir. 1996). Because there will not be a plan in the *Qualitech* case, Mellon does not qualify as a Section 1123 representative.

Unsecured Creditors of Cybergenics Corp., 124 S.Ct. 530 (U.S. Nov. 07, 2003) (No. 03-330) (dismissing pursuant to Rule 46.1). Thus, the *Mellon Bank* decision affords this Court the opportunity to provide clear guidance on the issue and answer that which was left unanswered in *Hartford Underwriters*.

III. This Court Should Grant The Writ Because The Seventh Circuit's Decision Will Impact The Fundamental Economics Of The Bankruptcy Process To The Detriment Of Unsecured Creditors.

Congress, through the Bankruptcy Court, has designed a system that provides a mechanism by which a debtor can sort out its financial affairs under the auspices of the Federal Court system. The bankruptcy system provides, among other things, a mechanism whereby a trustee or debtor-in-possession can attempt to pull back into the bankruptcy estate certain payments made during the ninety days prior to the filing of the bankruptcy case. This statute, the preference statute, provides the means by which the trustee can recover funds and provide for a more even distribution to creditors. As the legislative history of Section 547 explains:

> [M]ore important[ly], the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. *Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally*. The operation of the preference section to deter 'the race of diligence' of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section – that of equality of distribution.

H.R.Rep. No. 595, 95th Cong. 1st sess. 177-78 (1977), U.S.Code Cong. & Admin.News, 1978, pp. 5787, 6138. (emphasis added)[2]

The right to bring a preference action is an inchoate right that does not exist until the debtor files for bankruptcy. *Ehrlich v. American Express Travel Related Services Co., Inc.*, 202 B.R. 9, 12 (Bankr. N.D. N.Y. 1996) (preference actions "arise under" the Bankruptcy Code); *In re Fonda Group*, 108 B.R. 962, 966 (Bankr. D. N.J. 1989) (preference cause of action is created on date petition is filed). Because the cause of action does not exist prepetition, it is not an asset to which a prepetition secured creditor's lien could attach. L. King, 5 *Collier on Bankruptcy*, ¶552.02[5][d][i] at p. 552.04-16 (15th ed. 2003) (monies recovered as a result of a preference action are generally not considered "proceeds" because such actions can generally only be pursued by trustee). The preference recoveries, therefore, are typically available for distribution to all unsecured creditors in the case. In many bankruptcy cases, the recoveries of preference and other

[2] The federal courts have universally acknowledged the dual purposes of equality of distribution and preventing the economic dismantling of the debtor. *In re Jones Truck Lines, Inc.*, 130 F.3d 323, 326 (8th Cir. 1997) (stating that section 547 "is intended to discourage creditors from racing to dismember a debtor sliding into bankruptcy and to promote equality of distribution to creditors in bankruptcy."); *In re Ogden*, 314 F.3d 1190, 1196 (10th Cir. 2002) (reiterating dual purpose of preference statute). Thus, to promote equality of distribution, the "focus is not on the size of the debtor's estate; rather its essential function is to move the determination date of the estate backwards in time to effect a *redistribution* among creditors." *Carrozzella & Richardson v. Parete*, 270 B.R. 92, 99 (Bankr. D. Conn. 2001) (emphasis in original).

avoidance actions are the only funds available for distribution to unsecured creditors because the debtor's other assets are highly leveraged and all subject to the secured creditors' liens.

In a bankruptcy case, in order for a creditor to obtain a lien on preference actions, it must obtain prior court approval of the transaction that will give the creditor the lien. 11 U.S.C. §§363, 364. Such a lien typically arises in connection with a cash collateral or funding order entered in the first few days of the case. In that instance, the lender obtains such a lien in exchange for allowing the debtor to continue to utilize cash to operate.

Because causes of action on preference claims are often the only source of potential recovery for unsecured creditors, Bankruptcy Courts are understandably reluctant to grant such liens to secured creditors. In his 1998 letter to the Delaware bankruptcy bar, Bankruptcy Judge Peter J. Walsh of the District of Delaware made clear that in initial filings regarding cash collateral, "[a]bsent exigent circumstances, neither the loan documents nor the order should give the lender a lien position on avoidance actions." App. 106, ¶7. Indeed, many of the bankruptcy courts which have significant Chapter 11 caseloads require, by local rule, that proposed cash collateral orders, which provide for the granting of such liens, be highlighted. *See, e.g.*, Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California, Rule 4001-2; App. 97; Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Delaware, Rule 4001-2(a)(i)(D); App. 95; Local Bankruptcy Rules for the United States Bankruptcy Court for the Northern District of Illinois, Rule 4001-2(A)(2)(d); App. 93; Local Bankruptcy Rules for the United States Bankruptcy Court for the District of Massachusetts, Rule 4001-2(c)(4); App. 90;

Local Bankruptcy Rules for the United States Bankruptcy Court for the Southern District of Ohio, Rule 4001-2(a)(1)(F). App. 95.

The rationale for the Bankruptcy Court's reluctance to grant these liens on preference actions is simple. A debtor which files for Chapter 11 bankruptcy is desperate to keep operating. To operate, it must have the use of cash, and it typically seeks the permission from and cooperation with its current lender to use cash collateral that is otherwise subject to that lender's lien. The lender, who already has tremendous leverage at this point in a bankruptcy case, can, absent some prohibition, insist on a lien on the avoidance actions. And because the debtor is desperate to operate and being asked to give up the rights of unsecured creditors in exchange for the lender's agreement to allow the debtor to operate, the debtor is willing to grant the lien. Thus, the ability of unsecured creditors to recover in these cases is foreclosed at a point in time when the bankruptcy case is a few days old and no one has had a meaningful opportunity to review the debtor's books and records to determine if any significant preference claims exist.[3]

In this very typical scenario, the impact of *Mellon Bank* is enormous. The "level playing field" that Congress intended when it enacted the Bankruptcy Code may have now become even more uneven. The secured creditor – a party that already enjoys tremendous leverage – is now armed with a reported decision from a respected Court of

[3] Such a review could determine, for example, that the unsecured creditors stand to gain nothing in a sale or reorganization context, other than the proceeds of the preference actions. Thus, it would not be in their interests to permit them to be pledged.

Appeals panel saying that this arrangement is not only acceptable, but it also constitutes sufficient benefit to the estate such that the unsecured creditors must contribute to the secured creditor's recovery. This holding is a significant departure from Congress' intent of equality of treatment among similarly situated creditors. The *Mellon Bank* decision has encouraged a new currency with which the debtor and secured creditor can deal to the detriment of unsecured creditors. This Court should grant petitioners' writ of certiorari to decide these important questions of federal bankruptcy law.

CONCLUSION

A writ of certiorari should issue to review the important national issues raised by the Opinion of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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In the
United States Court of Appeals
for the Seventh Circuit

No. 03-2604

MELLON BANK, N.A., as agent for 14 prepetition senior lenders of Qualitech Steel Corp.,

Plaintiff-Appellant

v.

DICK CORPORATION and GE SUPPLY COMPANY,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.
No. IP 02-0040-C-M/S – **Larry J. McKinney, *Chief Judge*.**

SUBMITTED OCTOBER 20, 2003[1] –
DECIDED DECEMBER 4, 2003

Before BAUER, POSNER, and EASTERBROOK, *Circuit Judges*.

EASTERBROOK, *Circuit Judge*. Bankruptcy law entitles debtors' estates to recover preferential transfers, including payments on account of antecedent debts made during the 90 days before the commencement of the proceeding. 11

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[1] This appeal is successive to *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001), and has been submitted to the original panel under Operating Procedure 6(b). The panel has decided that further oral argument is unnecessary.

U.S.C. § 547(b). Preferences are recovered "for the benefit of the estate" (11 U.S.C. § 550(a)) and thus profit all creditors according to their statutory and contractual entitlements. We must decide whether the right to recover a preference is an asset of the estate that may be assigned or distributed to a particular class of creditors to satisfy their entitlements. A different way to put the same question is whether a suit on behalf of all creditors in the money is "for the benefit of the estate". Either way the issue is characterized, our answer is "yes."

The dispute arises from a complex series of transactions that can be summed up simply. When Qualitech Steel entered bankruptcy, it was in economic distress – that is to say, it had a negative operating cash flow. (Financial distress, by contrast, entails a positive cash flow that is not large enough to retire existing debts.) Qualitech's equity was worthless. Secured debts exceeded the value of its assets. Most creditors, both secured and unsecured, agreed that the best step was to sell Qualitech promptly as a going concern to someone willing to take the risk of trying to turn the business around. In order to finance its operations for the time necessary to effect a sale – Qualitech was burning through cash at a monthly rate of $10 million – a syndicate of lenders advanced some additional capital. In order to mollify the prepetition secured creditors that did not want to participate, the bankruptcy judge promised them that, if their position deteriorated during the interim, they would be entitled to dibs on as much as $30 million of Qualitech's remaining assets, including the value of any preference-recovery actions. *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001), held over the protest of the unsecured creditors that this promise was within the bankruptcy judge's authority,

and that the judge also properly found that the secured creditors' position had in fact deteriorated, entitling them to the first $30 million of any preference-recovery actions.

The sale price was insufficient to cover both the new super-priority loans and the original secured loans. The original secured lenders' unsatisfied debts exceeded the value of any anticipated preference recoveries. Because at this point the estate was penniless, a committee of the secured lenders advanced funds to finance preference actions through Mellon Bank, which was appointed as the creditors' agent to collect on behalf of the (dissolved) debtor in possession, Qualitech. Multiple preference-recovery actions have been filed; recoveries to date exceed $10 million. But Dick Corp. and GE Supply Co. contended that they need not return the roughly $1 million in last-minute payments they received. They advanced two principal arguments: first that the entitlement to pursue avoidance actions had been sold with Qualitech's business, and second that recoveries that would flow straight to the pockets of secured creditors are not "for the benefit of the estate" as § 550(a) uses that phrase. The bankruptcy judge agreed with both lines of argument and dismissed the actions. On an appeal under 28 U.S.C. § 158(a), the district judge rejected the first contention but accepted the second, and thus affirmed the judgment. 2003 U.S. Dist. LEXIS 9427 (S.D. Ind. May 9, 2003). We have jurisdiction of the creditors' appeal, because the order under review is the final decision in an adversary proceeding. 28 U.S.C. § 158(d).

Dick and GE (collectively the "preference recipients") ask us to affirm on the theory that the buyer of Qualitech's assets, rather than the secured creditors, owns any entitlement to recover preferential transfers. Although the

district judge disagreed with this contention, and the preference recipients did not file a cross-appeal, litigants may offer on appeal any properly preserved argument that supports the judgment. See *Massachusetts Mutual Insurance Co. v. Ludwig,* 426 U.S. 479 (1976). It is enough to say, however, that we agree with the district judge's treatment of this issue, for the reasons the judge gave.

Another potential show-stopper also requires little discussion. According to 11 U.S.C. § 547(b), a trustee or a debtor in possession may prosecute a preference-recovery action, and Mellon Bank is neither. See also *Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.,* 530 U.S. 1 (2000) (enforcing similar limitation in 11 U.S.C. § 506(c)). But Mellon Bank has stepped into the shoes of the dissolved Qualitech, acquiring the debtor's claim by means of the order we affirmed in *Qualitech Steel.* The Supreme Court's decision in *Hartford Underwriters* did not disturb decisions allowing a lineal descent of statutory rights. 530 U.S. at 13 n.5. Thus we need not determine whether creditors ever may pursue avoidance actions while a debtor in possession or trustee exists, and over their opposition, by a rationale along the lines of shareholders' derivative actions in corporate law. See *In re Xonics Photochemical, Inc.,* 841 F.2d 198, 203 (7th Cir. 1988). Cf. *Unsecured Creditors of Cybergenics Corp. v. Chinery,* 330 F.3d 548 (3d Cir. 2003) (en banc).

Thus we arrive at the question whether a recovery for the use of secured creditors can be "for the benefit of the estate". We say "can be" rather than "is" because, by the time Mellon Bank filed the first preference-recovery action, there was no "estate"; Qualitech is gone and its assets are in new hands. But an *ex post* inquiry misses the real benefit. The potential to recover funds from preference recipients

was put to use for the estate's benefit – at a time when Qualitech still existed and had unsecured creditors – when the bankruptcy court promised this value to the objecting secured lenders to compensate them for risk while new super-secured funds were raised and the assets were sold. Instead of calling off the sale, or distributing some assets to the secured creditors, or taking some other step that (the bankruptcy judge believed at the time) would have made creditors as a whole worse off, the judge used the value of these assets to protect the secured creditors' position and thus facilitate what appeared to be the most productive course of action. Qualitech's assets were sold, and unsecured creditors received a bonus of $7.5 million. (The record does not reveal why the secured creditors agreed to this departure from absolute priority.)

Having put the *prospect* of preference recoveries to work for the benefit of all creditors (including the unsecured creditors) *ex ante* by effectively selling them to the secured creditors in exchange for forbearance – and in the process facilitating a swift sale that was beneficial all around – the bankruptcy judge did not need to use them *ex post* a second time, for still another benefit to the estate; there was no further benefit to be had. We established in *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A.*, 140 F.3d 1111, 1118 (7th Cir. 1998), that § 550(a) is satisfied by an indirect benefit to the estate, and the point hardly seems arguable even as an original matter. (There are no decisions to the contrary, other than the one under review.) The estate's *ex ante* benefit is all that the statute requires. That much would be clear if the secured creditors had *purchased* for $30 million in cash (paid into Qualitech's estate before its assets were sold) the right to pursue the preference-recovery actions; it is no less clear when the

incoming cash takes the form of DIP financing that is secured in part by the promise that preference-recovery actions can be used to make good any losses the secured lenders otherwise must absorb.

Lest this way of resolving the issue be taken to assume that § 550(a) requires that some benefit flow to unsecured creditors, we add that the statute does not say this. Section 550(a) speaks of benefit to *the estate* – which in bankruptcy parlance denotes the set of all potentially interested parties – rather than to any particular class of creditors. What happens to recoveries that reach the estate's coffers depends on contractual and statutory entitlements. To see this, consider a business that is reorganized under judicial supervision rather than auctioned off. Suppose this firm has $10 million in cash (including receivables) plus assets that could be sold for $90 million, and $150 million in secured debt. The security interest includes a floating lien on inventory, cash on hand, and receivables. This firm belongs to the secured creditors; unsecured creditors are not legally entitled to a dime; any influx of cash will go to the benefit of secured lenders to reduce the deficiency. Yet no one doubts that this debtor in possession (or a trustee) could bring a preference-recovery action under § 547. The operating business counts as an "estate" without regard to the identity (and priority) of those who will receive distributions eventually. We cannot see any reason why a firm with the same financial attributes – that is, one in which both equity investors and unsecured creditors will be wiped out – can bring avoidance actions if the business is reorganized under the supervision of the senior lenders, but not if these lenders and the judge decide to sell the business as a going concern to a third party. Such a sale

does not injure preference recipients (or unsecured creditors), so there is no reason why it should entitle the preference recipients to keep the money.

A legal rule that the quick sale of a business precludes avoidance actions by eliminating any benefit to the estate would derail many beneficial sales (because selling the business would reduce its value by abandoning opportunities to recover last-minute payouts). Likewise it would encourage the managers to make preferential transfers to favored vendors (who would not need to repay the firm). Neither of these consequences would be desirable. Our prior opinion establishes that using the prospect of avoidance actions as additional collateral promoted an efficient disposition of Qualitech's business (or so, at least, the bankruptcy judge was entitled to conclude at the time the financing was secured). That would not have been possible if, as the preference recipients argue here, the transaction vaporized the collateral sought to be used. Our reading of the Bankruptcy Code avoids these problems and enables the judge and the creditors to choose between in-court reorganization and immediate sale by reference to their economic benefits rather than legal artifacts.

REVERSED AND REMANDED

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

United States Court of Appeals

For the Seventh Circuit

Chicago, Illinois 60604

JUDGMENT – WITHOUT ORAL ARGUMENT

Date: December 4, 2003

BEFORE: Honorable WILLIAM J. BAUER, Circuit Judge

Honorable RICHARD A. POSNER, Circuit Judge

Honorable FRANK H. EASTERBROOK, Circuit Judge

No. 03-2604

IN RE: QUALITECH STEEL CORPORATION and QUALITECH STEEL HOLDINGS CORPORATION, Debtors

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division No. 02 C 40, Larry J. McKinney, Chief Judge

The judgment of the District Court is REVERSED and this appeal is REMANDED, with costs, in accordance with the decision of this court entered on this date.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re QUALITECH STEEL CORPORATION QUALITECH STEEL HOLDINGS,	) IP 02-0040-C-M/S) District Court) Cause No.
MELLON BANK, N.A. as Collateral Agent for the Prepetition Lenders on behalf of Qualitech Steel Corp., Plaintiff, vs. GE SUPPLY COMPANY, Defendant,	) Case No. 99-3364-AJM-11) Case No. 99-3363-AJM-11) Jointly Administered Under 99-3364-AJM-11) Adversary Proceeding No. 00-298
MELLON BANK, N.A. as Collateral Agent for the Prepetition Lenders on behalf of Qualitech Steel Corp., Plaintiff, vs. DICK CORPORATION, Defendant.	) Consolidated for Purposes of Appeal) Adversary Proceeding No. 00-296

ORDER

This cause is before the Court on an appeal from a decision of the Bankruptcy Court on cross-motions for summary judgment in the adversary proceedings brought by the adversary plaintiff, Mellon Bank, N.A. ("Mellon"), against two defendants, GE Supply Company ("GE") and

Dick Corporation ("DC") (collectively, the "Defendants"). The Bankruptcy Court granted summary judgment to GE and DC and denied summary judgment to Mellon. On appeal, Mellon asserts that the Bankruptcy Court erred when it found that it lacked jurisdiction over the proceedings because the assets at issue had been transferred out of the estate and because Mellon lacked standing. Mellon also avers that the Bankruptcy Court erred in denying its summary judgment motion on the merits. The Bankruptcy Court also denied Mellon's motion for reconsideration, which Mellon asserts as error.

For the reasons discussed herein, the Court REVERSES the decision of the Bankruptcy Court that finds a lack of subject matter jurisdiction and AFFIRMS the decision of the Bankruptcy Court that Mellon lacks standing to bring suit against the Defendants.

I. FACTUAL & PROCEDURAL BACKGROUND

Qualitech Steel Corporation ("Qualitech") was launched as a start-up project finance venture. Appellant's Exh. 2, at 2. It was intended that Qualitech be a state-of-the-art specialty producer of steel with facilities in Pittsboro, Indiana and Corpus Christi, Texas. *Id.* Qualitech was a wholly-owned subsidiary of Qualitech Steel Holdings Corp. ("Holdings") (collectively, Qualitech and Holdings, "Debtors"). *Id.*

To finance the operation, Qualitech borrowed in excess of $265,000,000.00 from a group of financiers (the "Prepetition Senior Lenders") in the form of both term and revolving loans. *Id.* These loans were secured by first priority liens upon and security interests in substantially all of Qualitech's assets. *Id.* at 3.

On or about June 20, 1996, DC contracted with Qualitech for the construction of a proposed state of the art special bar quality mini-mill in Pittsboro, Indiana. According to the complaint filed against DC, in or about February 1999, DC received payments in the approximate amount of $550,000.00 from Qualitech in accordance with contractual arrangements. Appellees' Exh. 1.

GE sold gas turbine engines to Qualitech; it also serviced and supplied parts for those engines. According to the complaint filed against GE, it received alleged preference payments from Qualitech for those services and supplies in the amount of $344,349.65 during the period from January 26, 1999, through March 10, 1999. Appellant's Exh. 14.

On March 22, 1999, Qualitech and Holdings filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Indiana. Appellees' Exh 1. The record reflects that the bankruptcy action was filed in an effort to facilitate the sale of the Debtors' assets. *See* Appellees' Exh. 3, Exh. C., ¶ 5; Appellant's Br. at 4. At the time of the filing of the bankruptcy case, Qualitech owed DC in excess of $7,000,000.00; Qualitech owed GE in excess of $1,500,000.00. Appellant's Exh. 23, ¶ 3. Qualitech also owed the Prepetition Senior Lenders a large portion of the funds it originally borrowed.

When the Debtors filed their petition, they sought a financing order that would permit them to borrow from a group of lenders (the "DIP Lenders") the funds necessary to sustain operations. The DIP Lenders agreed to the loan in exchange for obtaining a super-priority lien in accordance with § 364 of the Bankruptcy Code. Appellant's Exh.1, Interim Order (I) Authorizing the Debtors to

Obtain Postpetition Financing with Administrative Superpriority and Secured by Senior Liens on and Security Interest in the Assets of the Debtors Pursuant to 11 U.S.C. §§ 364(c)(1), (2), (3), & 364(d)(1) and to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363(II) Granting Adequate Protection and (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001, at 1 ("Interim Financing Order"). According to the Bankruptcy Court, because the Debtors had no unencumbered assets with which to secure new loans, and because of the Debtors' poor operational status and continuing losses, they were forced to obtain financing on a super-priority, priming lien basis. *Id.* at 8, ¶¶ K & L.

On March 23, 1999, the Bankruptcy Court entered an order approving interim post-petition financing (the "Interim Financing Order"). *See id.* Pursuant to the interim financing order, the new senior liens granted to the DIP Lenders and the ongoing use of the prepetition collateral effectively displaced and subordinated the Prepetition Senior Lenders' liens on the prepetition collateral. Under those circumstances, the Bankruptcy Court determined that the Prepetition Senior Lenders were entitled to adequate protection of their interests in the prepetition collateral. *Id.* at 9 (citing 11 U.S.C. §§ 361, 363(e), 364(d)(1)).

Specifically, in its Final Financing Order the Bankruptcy Court granted the Prepetition Senior Lenders "a replacement security interest in and lien upon all the Collateral, subject and subordinate only to the Senior Liens granted to the Banks pursuant to this Order and the Credit Agreement" ("replacement lien") and "a priority claim pursuant to section 507(b) of the Bankruptcy Code, subject and subordinate only to the Superpriority Claims

granted to the Banks," both of which were "limited in amount to the aggregate diminution in value following the Petition Date as a result of the utilization of Cash Collateral and the granting of Senior Liens." Appellant's Exh. 3, Final Order (I) Authorizing the Debtors to Obtain Postpetition Financing with Administrative Superpriority and Secured by Senior Liens on and Security Interests in the Assets of the Debtors Pursuant to 11 U.S.C. §§ 364(c)(1), (2), (3) & 364(d)(1) and to Utilize the Cash Collateral Pursuant to 11 U.S.C. § 363 and (II) Granting Adequate Protection, May 13, 1999, at 20 ("Final Financing Order"). The Bankruptcy Court later determined that the amount of diminution in value of the Collateral was an amount not less than $30 million. Appellant's Exh. 10, Order Determining the Extent of the Prepetition Senior Lenders [sic] Replacement Lien Pursuant to the Final Financing Order, at 4 ("Replacement Lien Order").

In the Final Financing Order, the Bankruptcy Court defined "Collateral" as

> all now existing or hereinafter acquired personal and real property of the Debtors or their estates, of any kind or nature whatsoever, and the products and proceeds thereof, including, without limitation, all real property, personal property, general intangibles, claims, equipment, accounts receivable and inventory of the Debtors (as more particularly described in the Credit Agreement).

Appellant's Exh. 3, Final Financing Order, at 2. The Credit Agreement specifically described "Avoidance Recovery Property and Avoidance Claims of each of the Borrower

and the Parent" as Collateral.[1] *Id.* Exh. A, First Amended Postpetition Credit and Guarantee Agreement, § 5.2(ix). These terms included avoidance actions of the Debtors pursuant to 11 U.S.C. §§ 547 and 550, and any proceeds therefrom. *Id.* § 1.1.

The Bankruptcy Court supported its rulings with the following findings:

> M. The Debtors are unable to obtain unsecured credit allowable under section 503(b)(1) of the Bankruptcy code as an administrative expense or pursuant to sections 364(a) or (b) of the Bankruptcy Code except on the terms and conditions set forth herein. Financing on a postpetition basis is not otherwise available to the Debtors without the Debtors (i) granting, pursuant to section 364(c)(1) of the Bankruptcy Code, claims having priority over any and all administrative expenses . . . , (ii) securing, pursuant to section 364(c) and 364(d) of the Bankruptcy Code, such indebtedness with perfected first priority senior security interests in and liens upon all of the Collateral, and (iii) providing adequate protection of the Prepetition Senior Lenders' and

[1] An "Avoidance Claim" was defined: "Any claim of either the Borrower or the Parent to avoid a transfer either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise." Appellant's Exh. 3, Exh. A, First Amended Postpetition Credit and Guarantee Agreement, § 1.1. Correspondingly, "Avoidance Recovery Property" was defined: "Any property of either of the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim."

> Prepetition Subordinated Lenders' interests in the Collateral.
>
> N. Under the circumstances, no other source of financing exists, on terms more favorable than those offered by the Banks.

Id., Final Financing Order, at 9.

On June 30, 1999, the Debtors conducted an auction of their "assets." Appellant's Exh. 6, *In re: Qualitech Steel Corporation, Qualitech Steel Holdings Corp.*, Case No. 99-03364-AJM-11, Tr. of Auction Proceedings, June 30, 1999 ("Sale Tr."). At the auction, the "assets" were described by the auctioneer as "two facilities" and several leases and executory contracts associated with those two facilities. *Id.* at 5-8. The Prepetition Senior Lenders proffered a credit bid for both facilities in the amount of $180 million; which was determined to be the highest bid. *Id.* at 32-35.

On August 13, 1999, the Bankruptcy Court entered an order that approved the sale of substantially all of the assets of the Debtors (the "Sale Order"). Appellant's Exh. 7, Order Approving the Sale of Substantially all of the Debtors' Assets Free and Clear of all Liens, Claims, Encumbrances and Interests Pursuant to 11 U.S.C. § 363 and the Assumption and Assignments of Executory contracts and Unexpired Leases Pursuant to 11 U.S.C. § 365 ("Sale Order"). The Bankruptcy Court determined that the Prepetition Senior Lenders' credit bid was "the highest or otherwise best offer for the Assets, is reasonable and necessary and is in the best interests of the Debtors, their estates and their creditors." *Id.* at 4. The Bankruptcy Court defined "Assets" as

> all of the Debtors' rights, title and interests in and to the Collateral described by and contained

> in the Final Financing Order and the Prepetition Loan Documents together with such inventory, accounts receivable, materials ordered but not yet delivered to the Debtors, provided that with respect to the material ordered and not yet delivered to the Debtors, such materials have been or will be paid for. For the purposes of this Order such Collateral shall be referred to herein as the Assets.

Id. at 4 n.2. Subsequently, the sale occurred on August 25, 1999, where "substantially all of the Debtors' assets were sold . . . to the Prepetition Senior Lenders' designees, Qualitech Steel SBQ, LLC and Qualitech Steel Iron Carbide Corp," (collectively, the "Purchasers"). Appellant's Exh. 11, Stipulation and Order (A) Authorizing Prepetition Senior Lenders to Prosecute Avoidance Actions on Behalf of the Debtors and (B) Modifying the Automatic Stay to Permit Prepetition Senior Lenders to Apply Proceeds to Avoidance Actions, at 2 ("Avoidance Actions Order").

Several months later, on November 3, 1999, the Official Committee of Unsecured Creditors of Qualitech Steel Corporation (the "Committee") filed a motion seeking leave of the Bankruptcy Court to bring the Debtor's avoidance actions. Appellant's Exh. 8, Motion by the Official Committee of Unsecured Creditors: (A) To Determine Rights Under the Postpetition Financing Orders to Proceeds from Avoidance Actions; or in the Alternative, (B) to Convert These Cases to Cases Under Chapter 7, at 1 ("Committee's Motion"). The Committee's primary argument was that the value of the Debtors' Collateral had increased postpetition as a result of the postpetition financing arrangement and changes in the market for the Debtors' products. *Id.* at 4-5. Therefore, no lien could arise

in favor of the Prepetition Senior Lenders under the Final Financing Order. *Id.* at 5.

Mellon opposed the motion, arguing in part:

> Other than to observe that the Committee's lawyers have been unsuccessful in coercing the Senior Lenders into paying their fees above and beyond the negotiated "carve-out", one wonders why the Committee has insisted on engaging this dispute now, in advance of any showing that there are any preference recoveries to be pursued for the benefit of the estates. (Clearly, this would be necessary before the Court could authorize the expenditure of further fees by Committee counsel in pursuit of these recoveries. *See In re STN Enterprises,* 779 F.2d 901 (2d Cir. 1985). (The Committee has made no showing in this regard, otherwise leading one to conclude that its motion is not ripe for adjudication.)
>
> That being said, the Senior Lenders and the Debtors have undertaken such a preference analysis and recognize that there are recoveries to be pursued, albeit for the benefit of the Senior Lenders under their replacement and other liens.

Appellees' Exh. 4, Response of the Senior Lenders to Motion by Creditors' Committee to Determine Rights Under Financing Orders or to Convert the Cases to Cases Under Chapter 7, at 2 n.2.

However, on March 14, 2000, the Bankruptcy Court issued an order that denied the Committee's motion and ruled that there was a diminution in value of the Prepretition Senior Lenders' Collateral of not less than $30 million. Appellant's Exh. 10, Replacement Lien Order, at 4.

Specifically, the Bankruptcy Court made the following pertinent findings:

> 2. The aggregate diminution in the value of the Collateral of the Prepetition Senior Lenders from the Petition Date through the Sale Date as the result of the use of Cash Collateral and the granting of senior security interests and liens in the Collateral exceeds $30,000,000 and the Replacement Lien, the validity and priority of which hereby are reaffirmed without any derogation of its validity and priority arising under and by virtue of the Final Financing Order, which order in all respects shall remain unaffected by any provision of this Order, has attached to the assets of the Debtors comprising the Collateral, including the Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order.
>
> 3. As a result, the extent of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, including the Avoidance Recovery Property, be and hereby is fixed in an amount of not less than $30,000,000.

Id. The Committee appealed the Bankruptcy Court's order to both the United States District Court for the Southern District of Indiana and the Seventh Circuit. *See In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001); *Official Comm. of Unsecured Creditors v. Bank Group,* No. IP00-0496-C-H/G, 2001 WL 899637 (S.D. Ind. July 5, 2001) (BA543062). Both courts affirmed the Bankruptcy Court's decision.

On or about June 5, 2000, the Bankruptcy Court approved a Stipulation and Order (A) Authorizing Pre-Petition

Senior Lenders to Prosecute Avoidance Actions on Behalf of the Debtors and (B) Modifying the Automatic Stay to Permit Pre-Petition Senior Lenders to Apply Proceeds of Avoidance Actions ("Authorization Stipulation") between Qualitech and Mellon. Appellant's Exh. 11, Authorization Stipulation. The Authorization Stipulation states the following relevant facts:

> WHEREAS, pursuant to that certain "Order Determining the Extent of the Prepetition Senior Lenders Replacement Lien [P]ursuant to the Final Financing Order," entered on March 14, 2000 (the "Replacement Lien Order"), this Court determined that (a) the aggregate diminution in value of the collateral of the Prepetition Senior Lenders from the Petition Date through the Sale Date as the result of the use of cash collateral and the granting to the Banks of senior security interests and liens in the collateral exceeds $30,000,000 and (b) as a result, the amount of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, including, without limitation, the Avoidance Claims and Avoidance Recovery Property, is not less than $30,000,000; and
>
> WHEREAS, as a result of the foregoing, the Prepetition Senior Lenders have senior liens upon and security interests in the Collateral, including, without limitation, all Avoidance Claims and Avoidance Recovery Property; and
>
> WHEREAS, the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and
>
> WHEREAS, the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance

> Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expense.

Id. at 3. The Authorization Stipulation contained the following agreements, among others:

> A. The Prepetition Senior Lenders shall have the right, but not the obligation, to commence and prosecute adversary proceedings in the name of, and on behalf of, the Debtors, to recover Avoidance Recovery Property. With respect to any Avoidance Actions that the Prepetition Senior Lenders elect not to pursue, such Avoidance Actions shall be the subject of further order of the Court following the earlier of: (I) the full adjudication of all Avoidance Actions commenced by the Prepetition Senior Lenders, and (ii) 60 days before the expiry of the statute of limitations with respect to such actions.
>
> B. The Prepetition Senior Lenders shall have authority, but shall not be required, to settle any or all of the Avoidance Claims on terms satisfactory to the Prepetition Senior Lenders subject to the provisions of Bankruptcy Rule 9019; . . .
>
> C. The Agent for the Prepetition Senior Lenders shall have the authority to collect all Avoidance Recovery Property, net of reasonable costs of collection which shall be subject to Court approval, in repayment of the indebtedness secured by the Replacement Lien subject to disgorgement by the Agent for the Prepetition Senior Lenders to the extent that such net proceeds actually paid over to the Agent for the Prepetition Senior Lenders exceed the greater of: (i) the Replacement Lien; (ii) the Replacement Lien plus the amount of the pro rata share of the Prepetition Senior Lenders

> of any balance available for distribution to unsecured creditors; or (iii) the pro rata share of the Prepetition Senior Lenders of any amount available for distribution to unsecured creditors, all as may be determined by a final disposition of the determination of the extent of the Replacement Lien. . . .

Id. at 4-5.

Following the entry of the Authorization Stipulation, Mellon, on behalf of and in the name of, the Debtors, commenced a number of adversary proceedings with respect to Avoidance Claims, including the actions against GE and DC. In addition, Mellon commenced an action on behalf of the Debtors' estates seeking to avoid and recover preferential transfers made to Mitsubishi International Corporation ("Mitsubishi") and other related parties in the amount of $13 million. The Bankruptcy Court approved and authorized a settlement of that action in April 2001. Appellant's Exh. 22, Mitsubishi Settlement Agreement. That settlement occurred within the primary bankruptcy case with notice to all creditors, including GE and DC.

The Mitsubishi Settlement Agreement, approved and authorized by the Bankruptcy Court stated, in relevant part:

> A. The Motion constitutes a core proceeding and this Court has jurisdiction over this proceeding and the Motion pursuant to 28 U.S.C. Sections 157 and 1334. Venue in these Cases and this Motion is proper in this district pursuant to 28 U.S.C. Section 157(b).
>
> * * *

E. Following the commencement of the Cases, the Debtors sought approval pursuant to Sections 363 and 365 of the Bankruptcy Code for the sale of substantially all of their assets appurtenant to the business operations of the Debtors in connection with their specialty bar quality steel mill in Pitssboro [sic], Indiana (the "SBQ Assets") and with their iron carbide facility in Corpus Christi, Texas (the "IC Assets") (the "Sale"). By Order dated August 13, 1999 [(the "Sale Order")], the Court approved the Sale to the Prepetition Senior Lenders or their designee.

F. On or about August 26, 1999, the Sale was consummated and the SBQ Assets were transferred to Qualitech SBQ and the IC Assets were transferred to Qualitech IC.

G. On or about June 24, 1999, MISI filed Proof of Claim No. 295 in the amount of $96,432.83 and Mitsubishi filed Proofs of Claim Nos. 372 and 373 in the respective amounts of not less than $8,821,285.90 and $376,641.50 (together with all other claims, causes of action, rights and interests, known and unknown, now existing or hereinafter arising, in law and in equity, respecting the Debtors and their estates, the Contracts and the IC Plant (the "Mitsubishi Claims")[)].

H. On or about November 29, 1999, the Prepetition Senior Lenders filed an objection to Mitsubishi claim number 372 (the "Claim Objection").

I. In connection with and as provided in the Sale Order, on October 22, 1999[,] Qualitech IC and the Prepetition Senior Lenders moved pursuant to Sections 365 and 105 of the Bankruptcy

Code for an order approving the assumption by the Qualitech and the assignment to Qualitech IC of the Contracts, with a determination that the cure amount required for assumption was zero or, in the alternative, for a deferral of the time by which the Contracts must be designated for assumption and assignment (the "Assumption Motion").

J. The Claim Objection and the Assumption Motion constitute "contested matters" in the Cases within the contemplation of Bankruptcy Rule 9014.

K. By Order dated March 14, 2000 (the "Replacement Lien Order"), the Court: determined. . . . there was a diminution in value of the collateral of the Prepetition Senior Lenders in an amount exceeding $30,000,000; held the Replacement Lien of the Prepetition Senior Lenders to attached [sic] to the assets of the Debtors, including the Avoidance Recovery Property;. . . .

L. On June 8, 2000, the Court entered that certain . . . [Authorization Order] and thereby authorized Mellon to commence, prosecute and settle adversary proceedings in respect of avoidance claims of the Debtors arising under and by virtue of Chapter 5 of the Bankruptcy Code in the name of and on behalf of the Debtors.

M. Mellon, on behalf of the estate, commenced: . . . adversary proceeding number 00-381 against Mitsubishi seeking to avoid as preferential and/or fraudulent certain transfers . . . the complaint in such action seeking the recovery on behalf of the estate of Avoidance Recovery

Property within the contemplation of the Authorization Order and the Replacement Lien Order.

N. The totality of the litigation between Mellon, on behalf of the estate[s] and in its capacity as Collateral Agent for the Prepetition Senior Lenders, and the Mitsubishi Parties (the "Litigation"), . . . is extremely complex and involves a multitude of hotly contested facts both of a technical and non-technical nature. . . . [T]he litigation comprises several complex legal issues which have engendered, and in all probability will continue to engender, extensive motion practice and require substantial judicial resources to resolve. The prosecution of the Litigation on behalf of the estates has consumed and will continue to consume significant legal fees and litigation expenses, all of which, to the extent reasonable, will diminish a net recovery to the estates.

* * *

P. . . . [T]he Settlement is fair and equitable to the estates, will conserve judicial resources, and is in the best interests of the estates.

Q. The payment to the estates of sixty-five percent of the Settlement Amount (as defined below), net of the reasonable expenses of the Litigation, as set forth in the Motion, is well within the range of reasonableness in the context of the Cases and the Litigation.

NOW, THEREFORE, IT IS HEREBY ORDERED as follows:

* * *

> 3. At the Closing and in the manner specified in the Agreement: Mitsubishi indefeasibly shall pay to Mellon the sum of fifteen million dollars . . . of which 65% shall be allocated to the estates and 35% shall be allocated and paid over to the Purchasers (as defined by the Motion) (each net of expenses of Litigation); and the Letters of Credit shall be returned to Mitsubishi by Mellon, and upon such payment, the Letters of Credit shall be deemed canceled and the Prepetition Senior Lenders shall be deemed to have released their security interests therein.

Id. at 2-7.

The proceedings giving rise to the instant suit was commenced by Mellon, on behalf of the estates, on June 15, 2000, against GE and DC to recover the allegedly preferential payments made to GE and DC, respectively. On January 23, 2001, Mellon moved for summary judgment against the Defendants requesting, *inter alia,* that the Bankruptcy Court find as a matter of law that the transfers made to Defendants by Qualitech during the ninety days preceding the commencement of the Chapter 11 cases were preferential and/or fraudulent transfers pursuant to Sections 547 and 548 of the Bankruptcy Code, and that Mellon was entitled to judgment on those transfers against the Defendants under Section 550 of the Bankruptcy Code.

On the same date, both GE and DC filed cross-motions for summary judgment against Mellon. The Defendants argued that (1) Mellon lacked standing to pursue Avoidance Claims on behalf of the estate under Section 547 of the Bankruptcy Code, (2) that the recovery of the Avoidance Claims produced no benefit to the estates under

Section 550 of the Bankruptcy Code; and that, in the alternative, (3) the Bankruptcy Court lacked jurisdiction over the matter because Qualitech had abandoned its interest in the Avoidance Claims.

Two months later, in March 2001, the Debtors, through counsel, commenced as co-plaintiff in excess of ninety adversary proceedings to recover preferential transfers on behalf of the Debtor's estate. DeMarco, Aug.15, 2001, Decl. ¶ 2. Each complaint filed with the Bankruptcy Court contains an averment signed by Debtors' counsel that the Bankruptcy Court had subject matter jurisdiction over the actions. *Id.* Once the pending adversary proceedings, which "involve disputes among creditors over preferences, warranties, cure payments and liens," have been resolved, Debtors' counsel intends to dismiss the bankruptcy petition. Appellee's Exh. 3, Exh. C, Kohn Decl. ¶ 10.

The Bankruptcy Court held a hearing on the motions in this cause on February 15, 2001. By order dated August 6, 2001, the Bankruptcy Court denied Mellon's Motion for Summary Judgment and granted the Defendants' Motions for Summary Judgment. Order Granting Defs' Mot. for Summ. J., Aug. 6, 2001, at 1-2 ("Bank. Ct. Summ. J. Order"). The Bankruptcy Court found that

> Mellon cannot bring the Avoidance Actions because the Avoidance Claims were part of the collateral that was included in the "Assets" that were sold on August 13, 1999. Consequently, the dispute here is between non-debtors which does not involve property of the Debtors' estates and therefore the Bankruptcy Court does not have subject matter jurisdiction over these actions.

> In the alternative, the Defendants argue that, even if the Avoidance Claims were still property of the Debtors' estates, Mellon nevertheless lacks standing to bring these actions since only a trustee or debtor in possession is statutorily authorized to pursue such claims.

Id. at 10-11. To support these conclusions, the Bankruptcy Court found the following facts:

> 7. The Sale Order defines the property to be sold as the "Assets". The "Assets", in turn, consist of "all the Debtors' right, title and interests in and to the Collateral described by and contained in the Final Financing Order." See, footnote 2, page 4 of the Sale Order. The Final Financing Order, in turn defines "Collateral" as that term was defined in Section 5.2 of the document titled "Credit Agreement" which was attached as Exhibit A to the Final Financing Order. See DC Exhibit 4, Ex. A, Sec. 5.2.
>
> 8. Section 5.2 of the Credit Agreement, in turn, defines the Collateral as including "all Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent," i.e. Qualitech Steel Corporation and Qualitech Steel Holdings Corporation.
>
> 9. "Avoidance Claims" are defined in the Credit Agreement as "Any claim of either of the Borrower or the Parent to avoid a transfer by either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise."
>
> 10. "Avoidance Recovery Property" is defined in the Credit Agreement as "Any property

of either the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim." INDIANAPOLIS DIVISION, at p. 2.

11. On August 23, 1999, the sale of the Debtors' "assets" (as defined in the Sale Order) to the Prepetition Lenders closed. The assets used in connection with the Debtors' SBQ Facility were transferred to Qualitech Steel SBQ LLC and the assets used in connection with the I/C Plant were transferred to Qualitech Steel Iron Carbide Corp. (together, the "Purchasers"). As is acknowledged by Debtors' counsel, though, as of January 28, 2001, and as a result of the sale "all of Qualitech's assets have been sold or transferred and there are presently no assets in the bankruptcy estate to distribute." McIlvian Decl., Exh. C. ¶ 5.

* * *

19. . . . [C]ertain provisions [of the Authorization Stipulation] allowed the Prepetition Lenders to take action on their own. In particular, the Authorization Stipulation provides the Prepetition lenders with the authority to collect all proceeds of avoidance claims, net of collection costs, including attorneys fees, in repayment of their replacement lien. [Authorization Stipulation, ¶ C.] The Authorized Stipulation provided that these net proceeds of the Avoidance Claims might be "subject to disbursement" (as opposed to required to be paid) to the Debtor's estate [sic] *only if* the net proceeds exceed $30 million (e.g. the amount of the Replacement Lien), [*id.*]; and, until such time as the net proceeds in the avoidance claims exceed $30 million, the Authorized Stipulation provided that the automatic stay was modified to

> give the Prepetition Lenders the right to collect the net proceeds and apply these moneys [sic] to their debt. [*Id.* ¶¶ C, F.]
>
> 20. Although the Authorization Stipulation did not prevent or prohibit the Debtors from commencing any Avoidance Claim on their own behalf, it was recited in the Authorization Stipulation that the Debtors decided not to bring the avoidance action because they "determined that there is no equity in the Avoidance Claim for the Debtors or their Chapter 11 estates." [*Id.* at 3.]

Id., at 4-9.

II. STANDARD

When it reviews a decision of the Bankruptcy Court, the District Court acts as an appellate tribunal. Therefore, its review is governed by traditional standards of appellate review. Specifically, the Court "is constrained to accept the bankruptcy court's findings of facts unless they are clearly erroneous." *In re Excalibur Auto Corp.*, 859 F.2d 454, 457 n.3 (7th Cir. 1988). *See also In re Fedpak Sys., Inc.*, 80 F.3d 207, 211 (7th Cir. 1996); *In re Longardner & Assocs., Inc.*, 855 F.2d 455, 459 (7th Cir. 1988). "A finding is clearly erroneous if upon review of the entire record the reviewing court is left with the definite and firm conviction that a mistake has been committed." *Graham v. Lennington,* 75 B.R. 693, 695 (S.D. Ind. 1987). *See also Bowyer v. United States Dep't of Air Force,* 875 F.2d 732, 636 (7th Cir. 1989), *reh'g denied.* "Generally, as long as the bankruptcy judge's inferences are reasonable and supported by the evidence, they will not be disturbed." *Graham,* 75 B.R. at 695.

However, conclusions of law made by the Bankruptcy Court must be reviewed *de novo*. *See Excalibur Auto Corp.*, 859 F.2d at 457 n.3; *Longardner & Assocs., Inc.*, 855 F.2d at 459. And, where the challenged finding is a mixture of law and fact, the clearly erroneous standard is also inapplicable. *See Graham*, 74 B.R. at 965. With these general standards in mind, the Court will address the issues raised in the instant appeal.

III. DISCUSSION

A. THE PROCEDURAL POSTURE OF THIS CASE

At the outset, the Court must address the procedural posture of the questions before it. In its briefs Mellon repeatedly refers to the error by the Bankruptcy Court in resolving questions of fact. In other words, Mellon argues that summary judgment in favor of the Defendants on the issue of subject matter jurisdiction was improper because there were underlying factual disputes related to the terms of the sale of the Debtors' assets. However, regardless of the procedural posture in which the Defendants' arguments were raised regarding subject matter jurisdiction, the law on dismissal for lack of subject matter jurisdiction is clear: A court deciding whether or not it has subject matter jurisdiction "is free to weigh the evidence to determine whether jurisdiction has been established. Factual findings rendered during this process are reviewed for clear error." *United Phosphorus, Ltd. v. Angus Chem. Co.*, 322 F.3d 942, 946 (7th Cir. 2003) (en banc) (citations omitted). *See also Grafon Corp. v. Hausermann*, 602 F.2d 781, 783 (7th Cir. 1979); *Ace-Chi. Great Dane Corp.*, No. 89 C 8456, 1992 WL 44398, at *2 (N.D. Ill. 1992). In other words, the Bankruptcy Court must resolve the jurisdictional facts, and the ultimate decision of

subject matter jurisdiction is for the Bankruptcy Court not a jury. *See United Phosphorus,* 322 F.3d at 963 (J. Wood, dissenting) (citing 5A CHARLES ALAN WRIGHT & ARTHRU [sic] R. MILLER, FED'L PRACTICE & P. § 1350, at 234-35 (2d ed. 1990)). Within the procedural posture of this case regarding the Bankruptcy Court's subject matter jurisdiction, then, the Court will review the Bankruptcy Court's findings of fact for clear error, and its conclusions of law *de novo.* The party asserting jurisdiction bears the burden of proof. *Id.* at 946 (opinion of the court).

Mellon makes two primary arguments that the Bankruptcy Court's subject matter jurisdiction findings were in error.[2] First, it asserts that the Bankruptcy Court erroneously determined it lacked subject matter jurisdiction over Mellon's claims against GE and DC because the Avoidance Recovery Property and corresponding Avoidance Claims were in fact sold to the Purchasers in the Asset auction on June 30, 1999. Second, Mellon asserts that the Bankruptcy Court erroneously determined that Mellon lacked standing to bring this suit against GE and DC because Mellon's pursuit of those claims would confer no benefit to the estate under section 550 of the Bankruptcy Code. The Court will address each of these argument [sic] in turn.

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[2] The Court notes that unlike most disputes about subject matter jurisdiction over third party actions, there is little dispute here about whether recovery of Avoidance Claims as a general matter are within the subject matter jurisdiction of the Bankruptcy Court. The dispute here focuses on specific facts of this case that might have divested the Bankruptcy Court of jurisdiction over the Avoidance Claims at issue.

B. SUBJECT MATTER JURISDICTION – PROPERTY OF THE ESTATE

Mellon first challenges the Bankruptcy Court's finding that the Avoidance Recovery Property was sold to the Purchasers as part of the asset sale; therefore, the Bankruptcy Court lacked subject matter jurisdiction over the instant claims. The Bankruptcy Court found that the definition of "Assets" sold to the Purchasers as described in the Sale Order included Avoidance Claims. Bank. Ct. Summ. J. Order, at 4-5. Specifically, the Bankruptcy Court looked to the definition of "Collateral" in the "Credit Agreement." *Id.* at 4. The Credit Agreement defined Collateral to include "all Avoidance Recovery Property and Avoidance Claims of each of the [Debtors]." *Id.* In addition, the Bankruptcy Court found that Debtors' counsel acknowledged during a hearing regarding another subject that as of January 28, 2001, and as a result of the asset sale, "'all of Qualitech's assets have been sold or transferred and there are presently no assets in the bankruptcy estate to distribute.'" *Id.* at 5 (quoting McIlvian Decl., Exh. C. ¶ 5).

Mellon asserts that these finding [sic] ignore other contradictory facts that were before the Bankruptcy Court. Mellon contends that the Sale Order did not effect the sale of the assets to the Purchasers, it merely approved and authorized it; therefore, the definition of "Asset" contained therein is not controlling as to what assets were sold. If anything, Mellon asserts, the Sale Order creates an ambiguity about the definition of "Assets." Specifically, the Sale Order defines "Assets" to include the Collateral described in two other documents: the Final Financing Order and the Prepetition Loan Documents. Sale Order, at 4 n.2. By their nature, the Prepetition Loan Documents

cannot include Avoidance Claims or Avoidance Recovery Property as Collateral because those types of property were not contemplated prior to the Debtors' bankruptcy filing. Therefore, Mellon asserts, the Bankruptcy Court erred when it failed to consider other evidence to resolve the ambiguity about what "Collateral" was actually sold to the Purchasers.

Moreover, the parties to the sale have never acted as if the Avoidance Claims or Avoidance Recovery Property were sold to the Purchasers. In a sworn statement, Jennifer C. DeMarco ("DeMarco"), counsel for Mellon and present at the closing, affirmed that the Avoidance Claims and/or Avoidance Recovery Property were not transferred out of the estate. Appellant's Exh. 17, DeMarco Decl. ¶ 2. In addition, at the auction, the "assets" were described as "two facilities" and several leases and executory contracts associated with those two facilities. Sale Tr. at 5-8. Furthermore, the Purchasers have never acted as if they owned the Avoidance Claims. In fact, Mellon, the Debtors, the Purchasers and the Bankruptcy Court proceeded as if the Avoidance Claims remained part of the estates as evidenced by the suit against Mitsubishi and related entities, and subsequent settlement thereof. Specifically, the settlement agreement approved by the Bankruptcy Court reflects that the estates recovered the portion of settlement attributed to the Avoidance Claims while the Purchasers recovered the portion of the settlement attributed to non-estate claims. Appellant's Exh. 22, Mitsubishi Settlement Agreement ¶¶ Q & 3. Mellon argues that these facts clearly demonstrate that the Avoidance Claims and/or Avoidance Recovery Property were not part of the sale to the Purchasers.

In contrast, the Defendants contend that the Bankruptcy Court properly looked to the Sale Order to determine what assets were sold. Moreover, the definition of Collateral referenced by the Sale Order clearly includes Avoidance Claims and Avoidance Recovery Property. Furthermore, Debtors' counsel, on or about January 26, 2001, by declaration in another matter, stated: "All of Qualitech's assets have now been sold or transferred and there are presently no assets in the bankruptcy estate to distribute." Appellee's App. Exh. 3, McIlvain Decl., Exh. C, Kohn Decl. ¶ 5 ("Kohn Decl."). Therefore, according to documents regarding the assets sold, and Debtors' counsel's understanding of the assets remaining in the estates, the Bankruptcy Court was correct in concluding that the Avoidance Claims and Avoidance Recovery Property were sold to the Purchasers. Furthermore, DeMarco's affidavit is conclusory when it states that the Avoidance Claims and Avoidance Recovery Property were not included in the assets transferred to the Purchasers after the sale; therefore, the Bankruptcy Court correctly excluded it from consideration. In addition, the Defendants argue that the preference suits filed by the Debtors' estate after the motions for summary judgment were filed in this case cannot support Mellon's argument that the Avoidance Claims and Avoidance Recovery Property remained in the estates.

The Court finds that the Bankruptcy Court committed clear error when it determined that the Avoidance Claims and Avoidance Recovery Property were sold as part of assets to the Purchasers. The Court must start with the definition for "Assets" in the Sale Order. That definition references the definitions for "Collateral" in two documents, the Final Financing Order and the Prepetition

Loan Documents. The definition of "Collateral" in the Final Financing Order includes "personal and real property of the Debtors or their estates, of any kind or nature whatever . . . as more particularly described in the Credit Agreement." Appellant's Exh. 3, Final Financing Order, at 2. The Credit Agreement specifically describes "Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent" *Id.* Exh. A. But, the definition of "Collateral" in the Prepetition Loan Documents does not include Avoidance Claims or Avoidance Recovery Property. Therefore, the Sale Order's reference to the two documents to define the assets sold creates an ambiguity, which must be resolved by looking at other facts.

It is clear from the Sale Order that the Bankruptcy Court was approving the sale of assets that had occurred at the auction held on June 30, 1999. The transcript from the auction clearly describes the assets being sold: "two facilities" and several leases and executory contracts associated with those two facilities. Sale Tr. at 5-8. There is no reference to other personal property of the Debtors. Furthermore, on or about February 5, 2001, DeMarco, counsel for Mellon, declared that she had personal knowledge of the extent of the sale to the Purchasers and that the assets sold did not include either Avoidance Claims or Avoidance Recovery Property. Appellant's Exh. 17, DeMarco Decl. ¶ 2. Although this statement seems to contradict that of Debtors' counsel, Kohn, in another proceeding, the Bankruptcy Court apparently ignored other relevant facts consistent with DeMarco's statement and inconsistent with Kohn's statement. First, the declaration in which Kohn made the allegedly contradictory statement also alludes to further proceedings that must occur before the bankruptcy estates could be closed.

Appellee's Exh. 3, Kohn Decl. ¶¶ 10-11. Specifically, he declared:

> 10. Barnes & Thornburg's only remaining task as counsel to Qualitech in the bankruptcy proceeding is to dismiss the bankruptcy petition after all remaining "adversary proceedings" are completed. These proceedings involve disputes among creditors over preferences, warranties, cure payments and liens have been litigated and settled [sic] .
>
> 11. Barnes & Thornburg has no role in the adversary proceedings or disputes over preferences, warranties, cure payments and liens and Qualitech has no interest in those proceedings because the bankruptcy court has assigned all of Qualitech's interest to other parties. To the extent the adversary proceedings generate any additional assets for distribution, the bankruptcy court has already entered orders directing how those assets will be distributed.

Id. His statements here allude to further adversary proceedings in which Qualitech would not participate because the Bankruptcy Court had "assigned" those assets to other interested parties. But, the record indicates that the Avoidance Claims and Avoidance Recovery Property had not been "assigned" or otherwise transferred. Specifically, the Replacement Lien Order specifically grants the Prepetition Senior Lenders a security interest on "the assets of the Debros [sic] comprising the Collateral, including the Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order." No assignment or transfer of property occurs here; rather, a lien is created on the Avoidance Recovery Property. Based upon the Bankruptcy Court's reference to the sale in the same

sentence, the Avoidance Recovery Property was not an asset transferred pursuant to the Sale Order.

Neither is an assignment or transfer of the Avoidance Claims and/or Avoidance Recovery Property made later when the Bankruptcy Court authorized the stipulation. Specifically, the Authorization Stipulation gave the Prepetition Senior Lenders the right, but not the obligation, to pursue adversary proceedings on behalf of the estates. Authorization Stipulation, at 4, ¶¶ A, B, C. Moreover, the Bankruptcy Court specifically allowed for instances where the Prepetition Lenders chose not to pursue Avoidance Actions. *See id.* ("With respect to any Avoidance Actions that the Prepetition Senior Lenders elect not to pursue, such Avoidance Actions shall be the subject of further order of the Court. . . . "). The Authorization Stipulation required disgorgement of Avoidance Recovery Property collected by the Prepetition Senior Lenders when the net proceeds exceeded certain values. *Id.* at 5, ¶ C. The disgorged funds would be available for distribution to unsecured creditors of the estates. *Id.* Clearly this specific plan for pursuit and recovery of Avoidance Recovery Property would have been unnecessary if the Avoidance Claims and/or Avoidance Recovery Property had been sold to the Purchasers. Moreover, the orders give the Prepetition Senior Lenders the right to pursue the Avoidance Claims on behalf of the estates; there is no assignment or sale of the property.

Likewise, the Bankruptcy Court's later approval of the Mitsubishi Settlement Agreement pursuant to the Replacement Lien Order and the Authorization Stipulation confirms that the parties to the Asset Sale, including the Debtors and the Purchasers, were treating the Avoidance Claims and the Avoidance Recovery Property as assets

retained by the estates and subject to further orders of the Bankruptcy Court. While it is true that a party may contest jurisdiction at any point in a proceeding notwithstanding prior orders in the case, as argued by the Defendants here, the fact that the Purchasers did not proceed against either Mitsubishi or the Defendants in this case are facts that tend to show that the Avoidance Claims and Avoidance Recovery Property were not sold. The Mitsubishi Settlement Agreement discloses that the amount recovered in that action is in the millions. Appellant's Exh. 22, Mitsubishi Settlement Agreement ¶ 3. Furthermore, the amounts allegedly recoverable in the instant claims are considerable. It is reasonable to infer that the Purchasers would have tried to pursue these claims on their own behalf if they had purchased the Avoidance Claims and Avoidance Recovery Property at the Asset Sale.[3]

In addition, the Purchasers received a share of the Avoidance Recovery Property recovered in the Mitsubishi Settlement Agreement that was associated with non-estate claims. *Id.* Clearly this division of the proceeds from the Mitsubishi litigation would not have occurred if the Avoidance Claims and Avoidance Recovery Property were sold to the Purchasers; the Purchasers would have been [sic] claimed the entirety of the proceeds if they owned the claims.

Based on the facts and history of this case and upon review of the entire record, the Court "is left with the definite and firm conviction that a mistake has been

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[3] The Court expresses no opinion on whether the Purchasers would have standing to pursue such claims in the Bankruptcy Court or whether such claims would be successful.

committed." *Graham,* 75 B.R. at 695. The Bankruptcy Court's finding that the Avoidance Claims and/or Avoidance Recovery Property were sold to the Purchasers at the Asset Sale was clear error. Therefore, the Bankruptcy Court's conclusion that it lacked subject matter jurisdiction over the instant action was also in error. The decision of the Bankruptcy Court on the issue of lack of subject matter jurisdiction because the Avoidance Claims and/or Avoidance Recovery Property had been sold to the Purchasers is hereby **REVERSED**.

C. STANDING

Mellon next asserts that the Bankruptcy Court erred when it concluded that Mellon lacked standing to bring Avoidance Claims against the Defendants. Specifically, Mellon challenges the Bankruptcy Court's finding that "the instant avoidance actions do not meet the 'for the benefit of the estate' requirement under § 550" of the Bankruptcy Code. Bank. Ct. Summ. J. Order, at 2. To support this conclusion, the Bankruptcy Court found the following facts:

> 24. At the February 15th oral argument on the cross motions for summary judgment, counsel for Mellon admitted that the avoidance actions will not exceed 30 million dollars, thus preventing the estate from receiving any proceeds of the preference actions.
>
> 25. The Debtor's counsel's sole remaining task is to dismiss the bankruptcy petition after all remaining adversary proceedings have been completed. *See* McIlvain Dec. [sic], Exh. C, ¶¶ 5, 10. These adversary proceedings "involve disputes *among creditors over preferences,* warranties,

> ties, cure payments and liens . . . " and Qualitech has no interest in these proceedings. McIlvain Dec. [sic], Exh. C, ¶¶ 10, 11 (emphasis added).

Id. at 10. Mellon argues that the Bankruptcy Court erred when it found that the $30,000,000.00 post-petition loan did not benefit the estate. Mellon cites *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.),* 140 F.3d 111, 1118 (7th Cir. 1998), *Citicorp Acceptance Co. v. Robison (In re Sweetwater),* 884 F.2d 1323 (10th Cir. 1989), and *In re Trans World Airlines,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994), for the proposition that a "benefit to the estate" need not occur after the recovery of an Avoidance Claim, but rather may have occurred long before an avoidance action was filed. The Bankruptcy Court declined to accept this argument stating, in relevant part:

> [U]nlike the situations in either *Bergner* or *Trans World Airlines,* unsecured creditors in this case have received nothing. There was no plan. There was no reorganization, and unsecured creditors have no stake in the success of the reorganized debtor because there is no reorganized debtor. There was no fund established from which proceeds are to be distributed to unsecured creditors. As recovery of the avoidance claims will not reach the $30 million threshold, the Prepetition [Senior] Lenders will be the sole beneficiaries of the requested recoveries from Dick Corporation and GE Supply, bringing these action[s] will not inure to the benefit of the estate.
>
> 29. There is no bankruptcy or reorganizational purpose to be served by permitting this action to go forward particularly where, as here, there is no plan, there will be no distribution to unsecured

> creditors and the bankruptcy case, upon conclusion of these preference actions, will be dismissed. "Where recovery will benefit an entity other than the estate, Section 550's requirement that recovery be for the benefit of the estate is not satisfied." *In re Huntsville Small Engines, Inc.*, 228 B.R. 5, 13 (Bankr. N.D. Ala. 1998); *In re Metal Brokers Int'l, Inc.*, 225 B.R. 920 (Bankr. E.D. Wis. 1998). *See also In re Burlington Motor Holdings, Inc.*, 231 B.R. 874, 877 (Bankr. D. Del. 1999 (holding that successor corporation which had acquired all of the Chapter 11 debtors' assets lacked standing to bring preference actions, as "any recovery by the Successor Corporation is not for the benefit of the estate as required by § 550(a)"). *See also Congress Credit Corp. v. AJC Intern.*, 186 B.R. 555 (D.P.R. 1995) (finding no benefit to the estate and party asserting claims has no standing where party asserting preference action had a lien on the proceeds of the recovery of preference actions, requiring proceeds to go directly to that party and where unsecured creditors received none of the proceeds).

Id. at 24-25.

In contrast, the Defendants assert that the Bankruptcy Court properly determined that the avoidance claims in the instant suit would not produce a benefit to the estates. Because Mellon has admitted that the Prepetition Senior Lenders would be the only beneficiary of any money recovered from this suit, the Defendants argue that there is no benefit to the estates. Therefore, Mellon cannot have standing to pursue the claims pursuant to § 550. The Defendants also aver that the instant claims have not been properly assigned to Mellon pursuant to § 1123 of the Bankruptcy Code, therefore, the assignment provisions do

not help Mellon's case. GE and DC also argue that *Trans World Airlines* does not apply in this case because unlike in this case, the avoidance actions in *Trans World Airlines* were brought by a representative of the estate pursuant to a confirmed plan. There is no such plan in the instant suit. Defs.' Am. Resp. Br., at 21. Moreover, the facts of the instant case are different from those in *Bergner* where the estate's representative funded a $0.33 on the dollar payout to unsecured creditors under a reorganization plan. *Id.* Furthermore, the Defendants argue that notwithstanding the Authorization Order, the plain meaning of § 547 of the Bankruptcy Code prohibits anyone other than the trustee from bringing an Avoidance Claim. *Id.* at 22-25.

The Court finds that Mellon lacks standing to bring the instant claims. At the outset, the Court notes that the circumstances of this case are fairly unique in the context of the avoidance actions at issue in this case. The underlying bankruptcy case was filed under Chapter 11 for reorganization of the debtors. However, no reorganization plan was ever filed and the real and personal property of the debtors was sold. In that respect the case has proceeded more like a case filed under Chapter 7 for liquidation. In addition, no trustee has ever been appointed and the original counsel for the debtors has stated in the past that after the avoidance claims are closed, there is no work left for the bankruptcy court. As a result of these unusual circumstances, the parties have presented no precedential case law directly on point, nor was the Court able to find any.[4] Therefore, the Court must carefully focus on the

[4] There is one unpublished district court opinion worth noting because it comes close to the factual scenario of this case. *All Star Int'l*

(Continued on following page)

statutes under which Mellon seeks to recover in this case, law interpreting those statutes or closely analogous statutes, and the facts of this case. The facts pertinent to the standing issue are not in dispute.

Standing is an issue of law; therefore, the Court reviews the Bankruptcy Court's findings *de novo*. *See In re Davis,* 194 F.3d 570, 573 (5th Cir. 1999). *Cf. In re James Wilson Assocs.,* 965 F.2d 160, 168 (7th Cir. 1992) (treating an the issue of standing as one of law to review *de novo*). To have standing to invoke a statute, in this case § 550, Mellon must be one of the entities that the statute is intended to protect. *See In re James Wilson Assocs.,* 965 F.2d at 168; *Tucker v. Dep't of Commerce,* 958 F.2d 1411, 1416 (7th Cir. 1992). Section 550 states, in pertinent part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or,

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Trucks, Inc. v. Burlington Motor Carriers, Inc. (In re Burlington Motor Holdings, Inc.), No. 95-1559(JFK), 2002 WL 63595 (D. Del. Jan. 17, 2002). Pursuant to a plan of reorganization, the new owners of the debtor paid an amount to be distributed directly to the unsecured creditors and assumed liability for other types of claims. *Id.* at * 3. In exchange for this consideration, the new owners received substantially all of the debtors assets including the avoidance claims. *Id.* The court in *Burlington Motor Holdings* found that it would be inequitable not to allow the creditor to pursue the actions because it had bargained for the right to do so, and the original bargain had benefitted the estate, including unsecured creditors at the time it was made. *Id.* (citing *In re Maxwell Newspapers, Inc,* 189 B.r [sic] 282 (Bankr. S.D.N.Y. 1995); *In re Churchfield Mgmt. & Inv. Corp.,* 122 B.R. 76 (Bankr. N.D. Ill. 1990)).

> if the court so orders, the value of such property. . . .

11 U.S.C. § 550(a).

A plain reading of the statue [sic] would require that the trustee recover any avoidance recovery property for the benefit of the estate. Similarly, the language of § 547 and § 548, which form the basis for Mellon's claims against the Defendants, refer to "the trustee" as the operative party.[5] *Id.* § 547 (stating that "the trustee may avoid any transfer of an interest of the debtor in property . . . . "); *id.* § 548 (stating that "[t]he trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition. . . . "). In other words, under a plain reading of the statutes at issue, there are two questions, whether or not Mellon may stand in the shoes of the trustee and whether or not recovery by Mellon would benefit the estate.

When the Bankruptcy Court analyzed these two questions, it determined that the question of whether or not a creditor may stand in the shoes of the trustee turned on whether the creditor was pursuing interests common to all creditors. Bankr. Ct. Summ. J. Order, at 16 (citing *Ducker Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.),* 177 F.3d 774, 781 (9th Cir. 1999)). *See also id.* at 17-20 (analyzing the "representative of the estate" element of

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[5] Section 1107(a) gives a debtor-in-possession similar power. 11 U.S.C. § 1107(a) (stating that subject to certain limitations, "a debtor in possession shall have all the rights . . . , and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter").

§ 1123 and determining that the focus of the inquiry is whether the appointed representative's recovery would benefit the estate (citing *In re Sweetwater,* 884 F.2d 1323, 1327 (10th Cir. 1989); *In re Trans World Airlines, Inc. v. Travellers Int'l AG,* 163 B.R. 964, 973 (Bankr. D. Del. 1994); *N. Atl. Millwork Corp.,* 155 B.R. 271 (Bankr. D. Mass. 1993)). Therefore, the Bankruptcy Court focused its analysis on whether Mellon's recovery in this case would benefit the estate.

There is no question that in certain circumstance [sic] some courts have allowed individual creditors to bring avoidance actions on behalf of a trustee or a debtor. *See Avalanche Maritime, Ltd. v. Parekh (In re Parmatex, Inc.),* 199 F.3d 1029 (9th Cir. 1999); *Duckor Spradling & metzger v. Baum Trust (In re P.R.T.C., Inc.),* 177 F.3d 774 (9th Cir. 1999); *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Group),* 66 F.3d 1436 (6th Cir. 1995); *In re STN Enters.* 779 F.2d 901 (2d Cir. 1985); *McCarthy v. Navistar Fin. Corp. (In re Vogel Van & Storage, Inc.),* 210 B.R. 27, 32 (N.D.N.Y. 1997). *But see SouthTrust Bank v. WCI Outdoor Prods., Inc. (In re Huntsville Small Engines, Inc.),* 228 B.R. 9 (N.D. Ala. 1998); *Met-al, Inc., v. Gabor (In re Metal Brokers Int'l, Inc.),* 225 B.R. 920 (E.D. Va. 1998); *Fleet Nat'l Bank v. Doorcrafters (MI of VT) (In re N. Atl. Millwork Corp.),* 155 B.R. 271 (D. Mass. 1993). Many of those courts require special circumstances to exist before the creditor has standing. *See Parmatex, Inc.,* 199 F.3d at 1031 (requiring that the trustee stipulate that creditor could sue on his behalf and the bankruptcy court approved such stipulation); *In re P.R.T.C.,* 177 F.3d at 781 (requiring that a creditor pursue "interests common to all creditors"); *In re Gibson Group,* 66 F.3d at 1446 (requiring that a creditor or creditor committee show four elements before it

may have derivative standing, including that the inaction of a trustee or debtor in possession is "an abuse of discretion" or unjustified); *In re STN Enters.* 779 F.2d at 904 (requiring that the bankruptcy court approve creditor's action and that creditor show that debtor in possession had unjustifiably failed to initiate adversary proceeding); *In re Vogel Van & Storage,* 210 B.R. at 32 (requiring extraordinary circumstances, and finding them under the facts presented where the estate would maximize its recovery for the benefit of all creditors because the creditor had insulated the estate from loss by promising to pay the estate regardless of the outcome of the suit).

Although never squarely addressing the issue, the Seventh Circuit has suggested that a creditor may bring a form of derivative suit in the name of the debtor to recover for allegedly fraudulent conveyances; however, the creditor must first "convince the court that the debtor was shirking its statutory responsibilities." *In re Xonics Photochem., Inc.,* 841 F.2d 198, 203 (7th Cir. 1988) (citing *In re Automated Bus. Sys., Inc.,* 642 F.2d 200 (6th Cir. 1981); *In re Jones,* 37 B.R. 969 (Bank. N.D. Tex. 1984); *cf. Fox Valley AMC/Jeep, Inc. v. AM Credit Corp.,* 836 F.2d 366 (7th Cir. 1988)). This requirement is similar, in part, to the view adopted by the Sixth Circuit, which requires satisfaction of four elements before a creditor may have standing to initiate an avoidance action:

> 1) a demand has been made upon the statutorily authorized party to take action; 2) the demand is declined; 3) a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court, and 4) the inaction is an abuse of discretion ("unjustified") in light of the debtor-in-possession's duties in a Chapter 11 case. A creditor has met its burden to show

> standing to file an avoidance action if it has fulfilled the first three requirements and the trustee or debtor-in-possession declined to take action without stating a reason. The burden then shifts to the debtor-in-possession to establish, by a preponderance of the evidence, that its reason for not acting is justified.

In re Gibson Group, 66 F.3d at1446. Moreover, the Sixth Circuit has also held that "the lack of funds to pursue the suit [is] a sufficient reason for permitting [a] creditor to proceed in the trustee's stead." *Id.* at 1443 (citing *In re Automated Bus. Sys.,* 642 F.2d at 201).

Presuming, without deciding, that the Seventh Circuit would adopt the approach of the Sixth Circuit, which requires the creditor to show four elements before it has standing to pursue avoidance claims, Mellon's case clearly falls short. The facts in the instant suit establish that Mellon and the Debtors proffered a stipulation to the Bankruptcy Court that stated

> the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and . . . the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expenses.

Appellant's Exh. 11, Authorization Stipulation, at 3. Having assumed that the Avoidance Claims were property of the estates, the Authorization Stipulation evidences that Mellon demanded that the Debtors take action, that the Debtors declined to take such action, and that the Debtors were "shirking [their] statutory responsibilities"

because they refused to pursue the Avoidance Claims to avoid the expense. *In re Xonics Photchem.*, 841 F.2d at 203.

But, the Sixth Circuit's test also requires that the creditor show that "a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court." *In re Gibson Group,* 66 F.3d at 1446. Although, arguably, the Authorization Stipulation provides the cost-benefit analysis for the Bankruptcy Court when it states that "the Debtors have analyzed the Avoidance Claims and determined that there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates; and . . . the Debtors desire that the Prepetition Senior Lenders prosecute all Avoidance Claims on behalf of the Debtors in order to avoid burdening the Debtors' estates with further litigation expense," the analysis proves too much. The Authorization Stipulation states that the Debtors see no "equity" in the Avoidance Claims for either themselves or their estates. In the context here, the Court interprets "equity" to mean "value" or "benefit." Therefore, the evidence shows that regardless of whether or not a "colorable claim" exists, the Debtors and the Prepetition Senior Lenders agreed in the Authorization Stipulation that there is no benefit to the estates in recovering on the claims. Moreover, Mellon repeated this assertion in writing. Appellees' Exh. 4, Response of the Senior Lenders to Motion by Creditors' Committee to Determine Rights Under Financing Order or to Convert Cases Under Chapter 7, at 2 n.2. Under the Sixth Circuit's test for standing of a creditor to bring avoidance actions, Mellon has not shown the third element, that a colorable claim exists that would benefit the Debtors' estates if successful.

Even if the Seventh Circuit would apply a less stringent test than the Sixth Circuit and find that Mellon could stand in the shoes of a trustee or the Debtors in this case simply because the Debtor decided not to pursue them, the Court finds that the Bankruptcy Court correctly concluded that Mellon's recovery of any avoidance claims in this case would not "benefit the estate" as required by § 550. As discussed above, the Authorization Stipulation specifically delineates the Debtors' view that "there is no equity in the Avoidance Claims for the Debtors or their Chapter 11 estates." Appellant's Exh. 11, Authorization Stipulation, at 3. Mellon argues, however, that the benefit to the estate may have occurred prior to recovery of the avoidance property. Specifically, Mellon asserts that the Bankruptcy Court ignored

> the substantial benefit to the estate that resulted from the subordination of the [Prepetition Senior Lenders'] liens to new money, which permitted the Debtor[] to continue to meet its operating expenses to its employees and creditors (like GE Supply) in the ordinary course of its business and resulted in the distribution to the unsecured creditors in connection with the sale of a $7.5 million note.

Appellant Reply, at 8 (internal citations omitted). This is a "benefit" that occurred well prior to the recovery on any Avoidance Claims here. Mellon primarily relies upon three cases to support its position: *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.),* 140 F.3d 111, 1118 (7th Cir. 1998), *Citicorp Acceptance Co. v. Robison (In re Sweetwater),* 884 F.2d 1323 (10th Cir. 1989), and *In re Trans World Airlines,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994). In *Bergner,* an alleged preference transferee argued that the *Bergner* debtor in possession lacked

standing to bring an avoidance action under § 550, in part, because the recovery would not benefit the estate. *In re P.A. Bergner,* 140 F.3d at 1118. The preference transferee argued that because the unsecured creditors had already recovered on their claims, pursuant to the approved reorganization plan, those creditors would not benefit from the recovery of any alleged preference transfer. *Id.* In addition, the preference transferee argued that recovery by the reorganized debtor would only benefit the new owners of the reorganized entity. *Id.*

The Seventh Circuit held that a benefit to the reorganized entity in that case was sufficient to satisfy the "benefit of the estate" requirement of § 550. *Id.* (citing *In re Acequia, Inc.,* 34 F.3d 800, 811 (9th Cir. 1994); *In re Trans World Airlines, Inc.,* 163 B.R. 964, 969-71 (Bankr. D. Del. 1994)). The Seventh Circuit reasoned that the benefit to creditors under § 550 need not be direct. *Id.* Under the facts in *Bergner,* the Seventh Circuit agreed that the new owners of the reorganized entity would benefit from recovery of the avoidance claims. But, the new owners were the debtor's largest under-secured creditor, which in exchange for the equity in the new entity, funded $25 million of the distribution to the general unsecured creditors of the debtor. *Id.* Therefore, the Seventh Circuit concluded that to prohibit the creditor from pursuing the claim "would be in serious tension with the right of the debtor under § 1123 to continue pursuing claims after plan confirmation, as that right would mean little if it could be defeated by showing that recovery would not go to the original creditor group in its original form." *Id.*

Similarly to the factual scenario in *Bergner,* in *Trans World Airlines,* the alleged preferential transferee argued that the debtor in possession lacked standing to bring an

avoidance action under § 550 because the recovery would go directly to a single creditor as payment on secured notes, rather than benefit the estate for payment to other creditors. *In re Trans World Airlines, Inc.,* 163 B.R. at 969. The single creditor had loaned a significant amount of money to the debtor in possession in exchange for secured, super priority notes, payable by a certain date or payable upon recovery of the preference claim at issue. *Id.* at 968.

The District Court of Delaware held that standing was proper. *Id.* The *Trans World Airlines* court reasoned that § 550 merely required a benefit to the "estate;" a broader term than "creditors." *Id.* at 972. "There is no requirement that an avoidance action recovery be distributed (or 'committed') in whole or in part to creditors." *Id.* Moreover, under the facts in *Trans World Airlines,* the reorganization plan provided that each "unsecured creditor[ ] received, in full satisfaction of their claims, a pro-rata share of $58,440,000 in principal amount of new seven-year notes and 3,365,000 shares of new preferred stock." Therefore, the *Trans World Airlines* court found that "not only do the unsecured creditors benefit as shareholders, they benefit as noteholders. To the extent that the recovery will enhance the value of reorganized TWA, the noteholders, as well as other creditors of TWA, will benefit." *Id.* at 973. Moreover, the court concluded that "[t]he basic purpose of a recovery pursuant to § 550(a) is to enlarge the estate for the benefit of creditors. Any recovery by TWA here will do that." *Id.*

The instant facts are significantly different. Unlike in *Bergner* or *Trans World Airlines* where there was a confirmed reorganization plan that provided for some recovery of claims by unsecured creditors, or provided that either under-secured or unsecured creditors obtain equity

in the reorganized debtor, there is no confirmed reorganization plan in this case. Therefore, the protections normally afforded unsecured creditors through the confirmation process are absent. Moreover, there is no evidence that the unsecured creditors in this case have a stake in any reorganized debtor. In fact, the parties agree that no creditor other than the Prepetition Senior Lenders will benefit from the avoidance action at bar. In other words, no one save the Prepetition Senior Lenders is better off because of the recovery action.

Mellon argues that the estate and thereby it creditors were benefitted in the past by the DIP financing because the loans provided payment for goods or services provided to the Debtors prior to the sale of substantially all of the Debtors' assets. In addition, the DIP financing allowed for the sale of an ongoing concern and, ultimately, the assignment of a $7.5 million note payable to the Official Unsecured Creditor's Committee by the Purchasers. Mellon avers that this was a significant benefit to the estate and the creditors; therefore, the "benefit of the estate" requirement of § 550 is met. But, under the circumstances of this case, there is no plan or other commitment of a benefit on the part of the Prepetition Senior Lenders directly or indirectly to the other creditors (whether secured or unsecured). In fact, it seems as if the transactions that occurred in this case were entirely for the benefit of the Prepetition Senior Lenders because the Prepetition Senior Lenders financed the Debtors until a sale to the Prepetition Senior Lenders, at a loss to the Prepetition Senior Lenders, so that the Prepetition Senior Lenders could recover Avoidance Claims to pay off their loss. In other words, recovery in this case benefits no one but the Prepetition Senior Lenders. Finally, there were

never any assurances by the Bankruptcy Court that the Prepetition Senior Lenders would recover more than their fair share of the proceeds of the asset sale; their interest in the Avoidance Recovery Property was always contingent on a proper showing of standing. *Cf. In re N. Atl. Millwork,* 155 B.R. at 284 (commenting that although the sale order in the case authorized pursuit of avoidance claims by a creditor, nothing prevented the defendants from contesting the creditor's standing).

Mellon also relies upon the case *In re Sweetwater,* 884 F.2d 1323 (10th Cir. 1989). However, the facts of that case are much different from the scenario here. In *Sweetwater,* the administrative claimants agreed to different treatment of their claims pursuant to a reorganization plan that was affirmed by the bankruptcy court. *Id.* at 1324. The reorganization plan called for each administrative claimant to receive an interest equal to the allowed amount of their claim in a fund of cash and assets. *Id.* at 1325. The assets included the potential proceeds from an avoidance claim against a certain bank. *Id.* A trustee of the fund was appointed by the reorganization plan to recover any proceeds from the avoidance claim, reduce the assets to cash and disperse the funds to the administrative claimants according to the agreed plan. *Id.* Any overage was to revert to the debtor's estate for further distribution to other creditors. *Id.* The bank challenged the standing of the trustee arguing that there was no benefit to the estate.

The *Sweetwater* court held that the trustee had standing. *Id.* at 1326. The *Sweetwater* court reasoned that it was clear that the trustee's obligation was to prosecute the avoidance claims for the benefit of the administrative claimants pursuant to the confirmed plan. *Id.* at 1327. Moreover, to the extent the claims paid more than required

by the administrative claims, there would be more funds available to satisfy other unsecured creditors. *Id.* The *Sweetwater* court also held that the claims were not "assigned" to the trustee, rather, the claims belonged to the estate consistent with 11 U.S.C. § 1123. *Id.*

The instant case is clearly distinguishable. As already discussed above, there was no plan in this case in which any creditors agreed to different treatment of their claims. There was an agreement by the Prepetition Senior Lenders to subordinate their loans; however, that agreement did not purport to change the status of any other creditor's claim. Furthermore, there was no agreement by the creditors in this case to appoint Mellon or the Prepetition Senior Lenders to represent the interests of the creditors. To the contrary, the Official Creditors' Committee has asserted itself against the Prepetition Senior Lenders on other issues. *See In re Qualitech Steel Corp.,* 276 F.3d 245 (7th Cir. 2001); *Official Comm. of Unsecured Creditors v. Bank Group,* No. IP00-0496-C-H/G, 2001 WL 899637 (S.D. Ind. July 5, 2001) (BA543062). Finally, there is no evidence in this case that the recovery by Mellon would directly benefit any other entity than itself. For these reasons, the Court is not persuaded that the instant case should be likened to *In re Sweetwater.*

The Court has found that Mellon lacks standing to bring the instant action because it has failed to show that it may stand in the shoes of the Debtors and because it has failed to show that recovery in this case will benefit the

estates.[6] Therefore, the Bankruptcy Court's ruling that summary judgment in favor of GE and DC is appropriate should be **AFFIRMED**.

Having found that summary judgment in favor of GE and DC was proper, the Court declines Mellon's invitation to address the merits of its summary judgment motion.

IV. CONCLUSION

The Court has found that the Bankruptcy Court erred when it found that the Avoidance Claims at issue in this case were sold to the Purchasers in the asset sale, and therefore, the Bankruptcy Court lacked jurisdiction over the action. Therefore, the decision of the Bankruptcy Court that it lacked subject matter jurisdiction over the claims is **REVERSED**. However, the Court has also found that Mellon lacks standing to bring adversary proceedings against GE Supply Company and Dick Corporation because it failed to evidence that it could stand in the shoes of the Debtors and because it failed to show recovery would benefit the estates. Accordingly, the Bankruptcy Court's ruling that summary judgment in favor of GE Supply Company and Dick Corporation should be granted because Mellon lacks standing is **AFFIRMED**. Mellon's claims against GE Supply Company and Dick Corporation are dismissed without prejudice.

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[6] The Defendants also argue, in the alternative, that the Debtors have abandoned these claims, therefore, Mellon lacks standing. Having found that Mellon lacks standing for other reasons, the Court will not reach the Defendants' third argument.

IT IS SO ORDERED this 9 day of May, 2003.

/s/ Larry J. McKinney
LARRY J. McKINNEY,
CHIEF JUDGE
United States District Court
Southern District of Indiana

Distribution attached.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In re: Qualitech Steel Corporation Qualitech Steel Holdings	Case No. 99-3364-AJM-11 Case No. 99-3363-AJM-11 Jointly Administered Under 99-3364-AJM-11
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, on behalf of Qualitech Steel Corporation, Plaintiff, vs. Dick Corporation, Defendant.	Adversary Proceeding No. 00-296
Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, Plaintiff, vs. GE Supply Company Defendant.	Adversary Proceeding No. 00-298

FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING SUMMARY JUDGMENT MOTIONS

The Plaintiff, Mellon Bank, N.A. as Collateral Agent for the Prepetition Senior Lenders, commenced separate adversary proceedings by filing their separate Adversary Complaints against the Defendants, General Electric

Supply ("GE") and Dick Corporation ("DC"), to avoid and recover for the estate under Bankruptcy Code Sections 547 and 550 certain alleged preferential transfers. On January 23, 2001, the Plaintiff, GE and DC all moved for summary judgment. The cross motions for summary judgment were heard on February 15, 2001, wherein the Plaintiff in both adversaries appeared by counsel Andrew Brozman and Jennifer DeMarco; Defendant GE appeared by counsel Charleyne Gabriel; Defendant DC appeared by counsel Martin Weis. At the conclusion of the hearing, the Court instructed the parties to submit their respective proposed findings and conclusions. After several agreed-to extensions, the parties filed their respective findings and conclusions on June 1, 2001. Pursuant to Federal Rule of Civil Procedure 52, made applicable to this proceeding by Bankruptcy Rule 7052, the Court enters the following Findings of Fact and Conclusions of Law.

Findings of Fact

1. On March 22, 1999, Qualitech Steel Corporation ("Qualitech" or "Debtor") and its parent company, Qualitech Steel Holdings Corp., filed for Chapter 11 relief in the United States Bankruptcy Court for the Southern District of Indiana. *See* DC Exhibit 1, ¶8.[1] Thereafter, Qualitech operated as a debtor in possession. *See* DC Exhibit 1, ¶8.

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[1] References to "DC Exhibits" are to exhibits contained in Appendix Of Documents in Support Of Motion Of Dick Corporation for Summary Judgment.

2. Qualitech filed for Chapter 11 relief not to reorganize, but for the purpose of enhancing a sale of Qualitech's assets. *See* McIlvain Dec.[2], Ex. C, ¶5.

3. At the time of the filing of the bankruptcy case, Dick Corporation was still owed in excess of $7 million from Qualitech. *See* DC Exhibit 14, ¶6. At the time of the filing of the Bankruptcy Case, G.E. Supply was still owed in excess of $1,531,226.88 from Qualitech in unsecured debt. *See* Proof of Claim filed by G.E. Supply on 7/7/1999.

4. On May 13, 1999, this Court entered an Order ("the Final Financing Order") in the bankruptcy case approving the Debtor's financing arrangement with its prepetition lenders ("Prepetition Lenders") wherein the Court authorized the Debtors to incur postpetition financing pursuant to Section 364(d) which financing was secured by a senior priming lien on all of the Debtors' assets as set forth in detail in the postpetition credit agreement (the "DIP Financing"). In connection with the DIP Financing, the Court determined that the existing Prepetition Senior Lenders were entitled to adequate protection of their interests in the prepetition collateral, including existing cash collateral, for any diminution in value of the prepetition collateral, including without limitation, that resulting from the use of the cash collateral, the incurrence by the Debtors of postpetition financing secured by senior liens on the prepetition collateral

[2] References to "McIlvain Dec." are in the Declaration of J. Bradford McIlvain in Opposition to Mellon Bank's Motion for Summary Judgment.

and the use sale or lease of the prepetition collateral and the imposition of the automatic stay.

5. To that end and as adequate protection, the Court granted to the Prepetition Senior Lenders pursuant to the Final Financing Order a replacement lien (the "Replacement Lien") in all of the assets of the Debtor, including the proceeds (the "Avoidance Recovery Property") of avoidance claims arising under Sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code (the "Avoidance Claims"), and a superpriority administrative claim (the "Superpriority Claim") to the extent that the value of the prepetition collateral of the Prepetition Senior Lenders diminished following the Petition Date as the result of the DIP Financing.

6. Also in May, 1999, the Court entered an Order permitting Qualitech to auction its assets. *See* DC Exhibit 7, pp. 2-3. Therefore, on June 30, 1999 the Debtor conducted an auction of substantially all of the assets related or appurtenant to its iron carbide plant located in Corpus Christi, Texas (the "I/C Plant") and its special bar quality steel mill in Pittsboro, Indiana (the "SBQ Facility"). The end result of which was that Mellon, on behalf of the Prepetition Lenders, bid $180,000,000 of its lien and purchased substantially all of Qualitech's assets on behalf of designees of the Prepetition Lenders, Qualitech Steel SBQ, LLC and Qualitech Steel Iron Carbide Corporation. *See* DC Exhibit 7, pp. 2-3, and the sale was approved by this Court by order dated August 13, 1999 (the "Sale Order").

7. The Sale Order defines the property to be sold as the "Assets". The "Assets", in turn, consist of "all of the Debtors' right, title and interests in and to the Collateral

described by and contained in the Final Financing Order". See, footnote 2, page 4 of the Sale Order. The Final Financing Order, in turn, defines "Collateral" as that term was defined in Section 5.2 of the document titled "Credit Agreement" which was attached as Exhibit A to the Final Financing Order. *See* DC Exhibit 4, Ex. A, Sec. 5.2.

8. Section 5.2 of the Credit Agreement, in turn, defines the Collateral as including "all Avoidance Recovery Property and Avoidance Claims of each of the Borrower and the Parent," i.e. Qualitech Steel Corporation and Qualitech Steel Holdings Corporation.

9. "Avoidance Claims" are defined in the Credit Agreement as "Any claim of either of the Borrower or the Parent to avoid a transfer by either of the Borrower or the Parent under the Bankruptcy Code, including, without limitation, any claim for avoidance arising under sections 542, 544, 546, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code or otherwise."

10. Avoidance Recovery Property" is defined in the Credit Agreement as "Any property of either of the Borrower or the Parent that has been or could be recovered through the successful pursuit of an Avoidance Claim." *INDIANAPOLIS DIVISION.* at p. 4.

11. On August 25, 1999, the sale of the Debtors' "assets" (as defined in the Sale Order) to the Prepetition Lenders closed. The assets used in connection with the Debtor's SBQ Facility were transferred to Qualitech Steel SBQ LLC and the assets used in connection with the I/C Plant were transferred to Qualitech Steel Iron Carbide Corp. (together, the "Purchasers"). As is acknowledged by Debtor's counsel, though, as of January 28, 2001, and as a result of the sale, "All of Qualitech's assets have been sold

or transferred and there are presently no assets in the bankruptcy estate to distribute." McIlvain Dec., Ex. C, ¶5.

12. On November 3, 1999, following the sale of substantially all of the Debtor's assets to the Purchasers, the Official Committee of Unsecured Creditors (the "Committee") made a motion, in part, to determine the extent of the Replacement Lien granted to the Prepetition Senior Lenders in connection with the Final Financing Order and the rights of the Prepetition Senior Lenders (as Replacement Lien Holders) to the proceeds of Avoidance Claims. The Committee asserted that there was no diminution in the value of the prepetition collateral following the commencement of the Debtors' cases and, accordingly, that the Replacement Lien could not attach to any proceeds of Avoidance Claims.

13. The Committee's motion was opposed by, among others, Mellon which contended that Mellon, on behalf of the Prepetition Lenders had the right to all of the proceeds of the avoidance actions. *See* DC Exhibit 3. In one of its submissions opposing the relief, Mellon admitted that the proceeds of these actions exist solely for the benefit of the Prepetition Lenders:

> Other than to observe that the Committee's lawyers have been unsuccessful in coercing the Senior Lenders into paying their fees above and beyond the negotiated "carve-out," one wonders why the Committee has insisted on engaging this dispute now, in advance of any showing that there are preference recoveries to be pursued for the benefit of the estates. (Clearly, this would be necessary before the Court could authorize the expenditure of further fees by Committee counsel in pursuant of those recoveries. *See In re STN*

> *Enterprises,* 779 F.2d 901 (2d Cir. 1985).) The Committee has made no showing in this regard, otherwise leading one to conclude that its motion is not ripe for adjudication.)
>
> That being said, the Senior Lenders and the Debtors have undertaken such a preference analysis and recognize that there are recoveries to be pursued, *albeit for the benefit of the Senior Lenders under their replacement and other liens.*

DC Exhibit 3, p. 2, n.2. (emphasis added)

14. At a hearing on March 14, 2000 on the issue of the extent of the replacement lien, the Debtors provided evidence that "the value of the avoidance claims and the proceeds was less than Five Million Dollars ($5,000,000.00) in the aggregate." DC Exhibit 5, pp. 2-3.

15. As a result of the March 14, 2000 hearing this Court entered an Order Determining the Extent of the Prepetition Senior Lenders' Replacement Lien Pursuant to the Final Financing Order (the "Replacement Lien Order") which held that there was a diminution in the value of the collateral of the Prepetition Senior Lenders from the Petition Date to the Closing, as a result of the Debtor's use of the Prepetition Senior Lenders' cash collateral and the granting of the senior security interests and liens to the DIP Financing lenders, of not less than $30,000,000. This Court in the Replacement Lien Order specifically determined that the Replacement Lien "has attached to the assets of the Debtors comprising the Collateral, *including Avoidance Recovery Property, other than those assets transferred pursuant to the Sale Order.* . . . As a result, the extent of the Replacement Lien granted to the Prepetition Senior Lenders pursuant to the Final Financing Order in all Collateral, *including Avoidance Recovery*

Property, be and hereby is fixed in an amount of not less than $30,000,000." (Replacement Lien Order at decretal paragraphs 2 and 3) (emphasis added).

This Court ultimately denied the relief requested by the Committee.

16. In or about March, 2000, the Prepetition Lenders and the Debtors entered into a stipulation (the "Authorization Stipulation") proposing to assign and/or otherwise abandon the Debtors' avoidance actions to the banks. In response to objections raised to that stipulation, the Prepetition Lenders acknowledged that the purpose of the stipulation was for the Prepetition Lenders to recoup a small portion of their large losses in these cases from those who benefitted from avoidable transfers. *See* DC Exhibit 6, p. 2. In that filng, the Prepetition Lenders go on to provide an additional acknowledgment as to the value of the proposed actions:

> Concomitant to the determination of the Pre-Petition Senior Lenders' substantial replacement lien, the Debtors advised that, as a result of their investigation, they determined that there existed approximately $2,600,000 of potential recoveries for claims arising under Section 547 of the Bankruptcy Code. The Pre-Petition Senior Lenders believe the potential preference recoveries to exceed that amount but reasonably believe the amount to be significantly less than $30,000,000.

DC Exhibit 6, p.3, ¶4.

17. The Authorization Stipulation contained certain provisions designed to allow the Prepetition Lenders to monitor and oversee the prosecution of the Avoidance Claims on behalf of the estates with a modicum of control

from the Debtors and the Court. For example, the Authorization Stipulation authorized the Prepetition Lenders to settle any avoidance claims and a power of attorney to execute documents in the Debtors' names to effectuate any settlement, and required a proposed settlement of any Avoidance Claims to be subject to the provisions of Bankruptcy Rule 9019.

18. Likewise, the Authorization Stipulation obligated the Prepetition Senior Lenders regularly to file with the Court a report on the status of the actions commenced with respect to the Avoidance Claims. Finally, it provided that any Avoidance Claim that the Prepetition Senior Lenders elected not to pursue would be subject to further order of the Court to enable other parties in interests the opportunity to seek authorization to commence an action on behalf of the estates.

19. However, certain provisions also allowed the Prepetition Lenders to take action on their own. In particular, the Authorization Stipulation provides the Prepetition Lenders with the authority to collect all proceeds of avoidance claims, net of collection costs, including attorneys fees, in repayment of their replacement lien. *See* DC Exhibit 7, ¶C. The Authorized Stipulation provided that these net proceeds of the Avoidance Claims might be "subject to disbursement" (as opposed to required to be paid) to the Debtor's estate, *only if* the net proceeds exceeded $30 million (e.g. the amount of the Replacement Lien). DC Exhibit 7, p.3, ¶C; and, until such time as the net proceeds in the avoidance claims exceed $30 million, the Authorization Stipulation provided that the automatic stay was modified to give the Prepetition Lenders the right to collect the net proceeds and apply these moneys to their debt. *See* DC Exhibit 7, p.3, ¶¶C, F.